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RETIRE RICH

INVEST Rs.40 A DAY

P. V. SUBRAMANYAM

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INVEST RS.40 A DAY

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PREFACE

It is an unfair advantage for an author to have met upwards of 20000 financial advisers, 5000 doctors and innumerable others and talking about their dreams, goals, fears, about money. So I start with that advantage – and the disadvantage of not being secluded enough to get a clear vision.

I was surprised that there was no book specifically on the Retirement space – about 8 years ago when I wrote the first edition. Retirement is a time bomb – and we are not really prepared for it. I mean a lot of initiatives are needed from the government in terms of law, facilities, subsidies, initiatives, but this book is not about all that.

This book is about preparing you for retiring. At best it is a strategic book on how to accumulate money for a goal. That goal - being retirement. Obviously, the earlier you start, the better and easier it will be for you so this book is aimed at the young investor as much as it is aimed at the late starter. Clearly this book is about the accumulation phase – how much, and how to go about getting it. There is a chapter on calculators – but I would urge you to look for calculators available online and choose one with which you are comfortable.

There are mathematical examples too – but please put in your own numbers. Do not get overwhelmed or underwhelmed seeing the numbers! These are somebody else's numbers, not yours. Plug in your own numbers and play! In the real world problems are not delivered with a problem solving manual. Personal finance is not so much a science – it is less about finance and more personal.

Let me take this opportunity to thank all those people on whose shoulders I have stood for a better understanding of money, and of life in general.

About the author

PV Subramanyam is the CEO of www.subramoney.com, a financial blog that hopes to simplify finance and ask the right questions. The author believes that most learning should happen by finding answers to relevant questions that occur to one. His blog does exactly that.

An accountant by qualification and a lawyer by training, he has spent his time in the trenches of the financial services industry – brokerage, insurance, banking and personal finance. He has trained at many mutual funds, banks, life insurance companies and in the non-banking space too.

With years of experience under his belt, he has conducted over 1000 training and financial communication sessions across the country for general and specialised audiences. He also conducts financial planning workshops within corporate India, helping employees to save and invest better. His mission is to equip smart people with the tools to get richer.

PV Subramanyam has written a book on wealth creation called 'Retire Rich - Invest Rs. 40 a day. It has sold upwards of 150,000 copies so far.

Do take a look at personal finance ideas on his blog
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Is Retirement an Age or an Amount of Money?

CHAPTER

Is Retirement an Age or an Amount of Money? 1

Food for thought:
• What is retirement to you?

By most common definitions, you retire when you stop being part of the workforce, either by choice or by having reached the age limit prescribed by the government. Is this your dream of retirement?

However, retirement is easier to describe than define - in that, sometimes it is a state of mind. Retirement is when we no longer have to (or can) work for monetary rewards. It is normally seen as an age – and your retirement age is a function of your profession. Thus, gymnasts retire at 20, cricketers at 34, actresses at 32, actors at 75, salesmen at 50, other employees at 58 or 60 years, and doctors and lawyers when their bodies do not listen to their minds. Of course, one class beats them all — politicians retire at 90!

Not all retirement is voluntary or mandatory: sometimes retirement is forced on you, due to unforeseen circumstances. For example, a surgeon or a dentist with failing eyesight or trembling hands may have to seek semi - retirement.

Will we ever retire?

Many people do not look forward to retirement because they do not know what to do post - retirement. Some others want to work until they drop dead. However, in a country where the workforce sees a constant influx of young aspirants, this choice may not be available.

Some people look forward to retirement, or so they would like to believe. Given the pressures of a daily working life, such a feeling can be exaggerated, when all you need is a 3-week break. One option that many people like to consider and hope for is semi-retirement.

IF WE ARE VERY BUSY OR TIRED, WE THINK TO OURSELVES, "I WISH I WAS RETIRED." BUT, WE RARELY PREPARE OURSELVES FOR RETIREMENT. THE IRONY IS THAT THESE SAME PEOPLE DO NOT EVEN TAKE A VACATION – A FORM OF 'TEMPORARY' RETIREMENT.

Semi-retirement is seeking a job that allows you to slow down while continuing to be productive, in monetary terms. A very good example is M S Dhoni choosing not to play Test cricket matches and focus on shorter forms, so that his body is in good shape to play until 2020.

A similar analogy in a corporate environment would be a Sales Head deciding to give up a sales job at 52 and taking up training, mentoring and coaching for the sales force. This profile could enable him to work until 65 years. At that age, he may be able to do some consultancy and hand holding for the sales force. However, if he had continued to be in active sales he may have burnt out by 55 years.

MR. DEEPAK PAREKH AND MR. AZIM PREMJI ARE BOTH MORE THAN 70 YEARS OF AGE — AND THEY ARE IN EMPLOYMENT BY CHOICE.
IF YOU ARE EMPLOYED BY NECESSITY, AND HAVE TO KEEP A JOB AT AGE 70, THEN IT MEANS YOU HAVE NOT INVESTED SMARTLY ENOUGH TO RETIRE.

The advantage of slowing down is mutual — the organization gets to keep the employee for a longer period, the positions are non-competitive, the employee is not looking for a new job every day, and all the experience is effectively used to everyone's advantage.

When can we retire?

Many of us fancy retirement — and it is in our hands to make it happen exactly the way we want it to happen. When we can retire is a function of how much money we need for retirement — and how much of this is already available. Retirement is voluntary for businessmen, and even for people in service, a post-retirement job is a possibility. However, for many people retirement is a luxury. For many of us, longevity will surely be an issue–the longest portion of our life may be spent in retirement. I know of employees who retired at 55 and then lived until the age of 95! Assuming that you started work at 24, retired at 55 and lived until 87, it would mean that for 24 years of your life you were a student (dependant on parents' earnings), 31 years in service (your earnings supported you) and 32 years in retirement (you need to create your own pay cheque). The challenge is to make the money earned (post taxes) pay off the educational costs, meet all your day-to-day needs, wants and luxuries — and look after your needs for 32 years after you stop earning. That will be a great challenge — for both you and your financial advisor.

So when can we retire is a simple question to answer. When you have enough money to retire, you can. It can happen at 35, 40, 55 or 85 — depending on how well you have managed your money. This brings us to one very important wealth management lesson — the amount of money you have at the end of your working life is a function of how well you have managed your money.

And how do you manage your money to your advantage?

That is a question that most of us have to answer for ourselves. Some of us are investment savvy and would like to manage our money ourselves. Many people I know would like to outsource money management, but monitor it on a regular basis, based on reports from fund managers. There are yet others who say, "I have given it to a financial planner, and I hope he is

doing a good job." Whichever category of investors you belong to, you need to start and build a retirement corpus. Immaterial at what age you start, you need to invest for your money to grow, for your 'retirement nest egg' to expand. If you are lucky enough to start young, invest aggressively in a high amount of equity, and start re-balancing when you are 60. If you are older, invest more conservatively – simply because there is not too much time available for correction.

The most important aspect in retirement is how well you manage your money while in the 'saving and investing' (called accumulation stage) stage and how well you manage your money while in retirement (called the withdrawal stage). It is very important that for long periods of time, most of your money has to be in the growth mode — considering that you want your money to outlive you.

Retirement planning is now a huge challenge because a large portion of the population does not have an indexed pension (except Central Government employees who have joined prior to 2004, and the Defence forces), and interest rates are not very high in real terms. A few generations ago, retirement planning was easy – pensions, National Savings Certificates, Kisan Vikas Patra, company fixed deposits – this is what made up a retiree's portfolio. However, people retiring in the 1980s up until 2000 did include some equity in their portfolio. Most of these people had one major advantage– in major Indian cities, real estate had appreciated considerably. This enabled a more diverse portfolio.

Not All Is Lost. Make A Realistic Calculation And See If You Can:

- **Postpone Retirement**
- **Live Frugally**
- **Save Aggressively**
- **Give Up Assets That You Thought You Would Give Up At Retirement (For Example, The Second Car)**

If you are 43 years of age, I can assure you, your house will not appreciate by more than 8% p.a., your equity returns may not be their its peak for another few years, inflation may be high, you may be addicted to branded goods, and you may have to prepare for a long life. Your grandparents or parents may not have had this problem.

Now, take out your retirement calculator, punch in the numbers, and surprise, you find you cannot retire at the age of 55 years. What do you do now?

How to retire successfully?
Visualization helps!

If you have crossed the age of 33-34, or are somewhere in the middle or towards the end of your working career, at some point, you've clearly imagined what your retirement will look like. Is it a nice sunny beach and golf in the mind or is it worries about medical bills? That picture in your mind will certainly change over the years, as you near the time when you're ready to hang your boots.

But what does it really take to retire?

Have you put a plan in motion for yourself, to make sure your arrival into retirement is pleasant?

Ask yourself some very important questions:

How much you will need for retirement depends on 4 additional (but important) factors:

1. **How long you and your spouse will live**
2. **How well your investment portfolio performs**
3. **Inflation**
4. **How well you have anticipated your expenses and managed your drawings from your corpus**

Can I afford to retire?

At some stage you will face this question: How much wealth must I accumulate on my own, to say I am financially free? The answer actually depends on what lifestyle you desire for yourself in retirement. This answer will lead you to the next steps in your quest for a comfortable retirement. Most people I know have adjusted their expenses according to the surplus available with them – rather than the other way around.

Step 1: Estimate Your Expenses

Take a few minutes to estimate your current annual household expenses (in today's rupees). Adjust these expenses to allow for the changes that will occur when you retire: presumably no more mortgage payments, perhaps one car instead of two.

Now there may be many things that you will not do but will take up:

You may reduce your commuting expense, but take up golf; you may eat out less often, but vacation more. These assumptions are individual and only you can correctly estimate your retirement expenses.

Your estimation may surprise you and you may find that you can get by quite nicely on less than 70% of your current income.

Step 2: Add Up Your Investments

After you've projected your retirement budget, figure out the value of your investment portfolio. The amount of wealth you've already locked away will make a tremendous difference in determining how much you need to save between now and retirement. If you are planning to retire to a smaller house (or in a less expensive location) there could be a surplus generated by conducting that transaction.

Many people may not know their net worth unless they have worked with a financial planner. You may be astonished at how well your investments have done! Check the numbers about once a year. You may be in better shape than you think!

The easy part is over!

Unfortunately, all these numbers are just guesses. The more conservatively you estimate, the better. However, balance is imperative. The key is living a fulfilling life, not tightening your belt for the better part of your life and not being able to enjoy it later on. No amount of financial modelling or juggling can prepare you for a 62% fall in equity markets, or for inflation at 14% p.a., or if you live to be 105!

Be sure to use stable numbers that are indicative of the times we live in.

Inflation and yields

I am assuming a 4% real return, composed of a 10% yield on your portfolio reduced by 6% inflation. This is possible in a retirement account, mutual fund or other tax-sheltered vehicle. The result won't change much if inflation turns out to be 5% or 3%, as long as your portfolio continues to net 4% more.

Is this rate too conservative? Why not say 7% or 8%?

A person with 15 years to go can make such an assumption. By investing a serious portion of your wealth in equity shares, you may be able to boost your overall portfolio return to 6%, or even higher (before inflation). Net of inflation, you may get a real return of 6-7% with growth shares or growth-type mutual funds. However, for it to affect your total return considerably, the amount invested in equities should be significant!

Indeed, I recommend such an approach for younger people. But, if you've got 10 years or less to retirement, you should plan conservatively.

Going forward we will see how to invest, where to invest after you retire, how to correct for mistakes, and much more. This book is a largely do-it-yourself kind of book, where I give you pointers and methods to maximize your investments. But to make this book work for you, you must use the methods and concepts described in the book to save for a rainy day, not read during rainy days!

CHAPTER 2

First Things First – Stop Pretending You Are Rich!

CHAPTER

First Things First – Stop Pretending You Are Rich! 2

Food for thought:
• What to do before you start mapping plans

Accumulating money has two stages – saving and investing. Both are not easy. Saving is a deliberate delay in consumption. It comes from learning patience. Patience is like meditation – it has to be learnt by you yourself. A teacher has a small role to play. So whenever you feel you need something, LEARN to postpone that purchase/ indulgence. Not because you cannot afford it, but because you need to strengthen your resolve. It's no walk in the park, but definitely doable.

'You can't wake a person who is pretending to be asleep.'
- Navojo Proverb

Most fathers – or should I say parents – live a fairy tale life. It makes it impossible for them to scale down their 'I deserve this' life style. So, if you are a parent who is earning well and spending well there is a need for you to ask yourself some questions. Here are some of the questions that I have been forced to ask my friends/clients /students when they came to me for their financial planning requirements:

1) Have you provided for your OWN retirement before you pay for your children's indulgences?

2) How are you going to tell your daughter that you cannot afford to pay US $ 200,000 for that education abroad?
3) How did you tell your family that you could afford that trip to Disneyland?
4) You have exactly Rs. 1 crore net worth at age 51. With what face will you confront your retirement?
5) You are 47, unemployed, and perhaps unemployable. How will you pay for your daughter's foreign education?
6) Some of the educational degrees have no ROI. Chief, you cannot afford them, better reconsider.
7) Your kids cannot, cannot, cannot afford to do those expensive courses unless you show me 1 million US $, with a big part of that earmarked for YOUR retirement, apart from your house, of course.
8) How prepared are you to lose your job tomorrow?
9) Remember that the great net worth that you are talking about has been contributed by your dad in the form of a house!
10) If your father's portfolio was given away to charity, YOUR old age would have been in misery.
11) You want to help somebody? You need to begin by helping yourself.
12) Is it your ego which prevents you from telling your family you really cannot afford that fancy Rs. 69 lakhs Jaguar?
13) Think again whether you can afford your annual vacation in India if you insist on air travel and 5-star deluxe stay!

Have you asked yourself these questions?

If not, it's high time you do.

CHAPTER 3

Why Should I Plan for Retirement?

CHAPTER

Why Should I Plan for Retirement? 3

Food for thought:
• Why plan retirement?
• What affects retirement?
• How many steps to the Retirement corpus?

Questions come first. And then comes clarity.

Let's start by understanding what retirement planning is.

Retirement planning is understood by people in many ways — what to do with the spare time on your hands, where to settle down after you have left the corporate world, whether to move and when to move into a retirement home, and so on. Here, we are talking about how you should plan your retirement financially. In this chapter, we discuss money. We debate when to start investing exclusively for retirement (earmarking funds for investments), at what age to retire, the various types of insurance — life, medical, and critical care — and whether you need it.

The reasons why you need to undertake retirement planning are not very different from why you need to do financial planning.
Retirement planning is a very complex process, one that is easier to describe rather than define. Let us analyse the factors that go into successful retirement planning.

"Failing to plan, is planning to fail"
Unknown

The financial service industry, or in our case, the people designing mutual funds, life insurance and pension products, force us to look at financial planning as a necessary step of managing our life, through a barrage of literature and advertisements. Retirement planning is an integral part of the overall plan.

1. ***Timing of retirement:*** For most people, when they want to retire may not be in their hands, if they work in a large or multi - national or government organization. However, by taking a second job (post retirement) you could retire say at age 65 instead of the stipulated age of 58 years.
2. ***Post - retirement lifestyle.***
3. ***Post - retirement location:*** For most people, their current home is convenient to travel to their workplace or the children's school. That could change after you retire, when you want to move away from the humdrum of city life.
4. ***Physical and mental preparation.***
5. ***Money:*** Being self - sufficient and creating your own pay cheque.

There are many reasons why you need to plan for your retirement at all. Let us enumerate some of them:

1. To protect you and your family against financial risks

Financial risks include early death, critical illness, accidents reducing your ability to and so on. It is essential to create a mechanism or safety net to protect your earnings, ensuring that they do not erode but grow.

2. To reduce or eliminate personal debt

Too many people spend money that they are yet to earn! This ensures high pressure on their future cash flows. One major worry about debt is the high cost at which it is available. In case you take a loan on your credit card, you will end up paying about 51% per annum as interest. If you keep a lifestyle supported by a high amount of debt, your ability to save for your retirement will be adversely affected.

3. To ensure your lifestyle even when you live long

Unfortunately, this is a risk. Considering that the average life span has increased compared with earlier generations, the associated costs of living will have to be taken care of.

4. To support career switches and big-ticket expenditures

Our working options have increased considerably in the past decade or so. There are many alternative, lucrative careers that will help you move out of the career you've been pigeonholed into. You will still need an income when you are testing new waters in an alternative career path. Big - ticket expenditures include your children's education, sometimes higher education, their weddings or even contributing to your grandchildren's wedding or education expenses.

5. To support the cost of raising kids

These days, a good schooling, may be a professional degree, and that foreign MBA can total a crore or so. Most parents are unprepared for these expenditures, as they do not correctly estimate the cost of education 10 years from now.

6. To take care of unforeseen risks

You may not understand all the risks that you run in your life and in your journey to achieve those goals. Most risks entail the unforeseen loss of money or income, so it is necessary to look ahead and ensure that retirement is hassle-free.

7. To afford all the assets that you will buy in life

Contrary to what Robert Kiyosaki, the author of the Rich Dad, Poor Dad series believes, we will continue to call a house, a car, nice golf kit, and the

luxuries of life assets!

8. To be able to retire

At a time of your choosing and in a style that you want to. You do not want to be at the mercy of your kids, do you? So, creating enough money to help you in your 'old age' (that means you, even if you do not like the expression or even if you are in your twenties) is an important goal of financial planning.

9. To pay for un - insurable medical expenses

When you retire, you may not be in the best of health. A full-time maid or nurse or aided living will cost money. Your medical insurance has its limitations – something your financial plan should keep in mind.

10. To leave money for your kids after your death

Leaving assets to your children is not obligatory – after all, you paid for their education and contributed to their wedding. Nevertheless, if you like the idea of leaving something for your children or grandchildren, then this should be a part of your financial plan too.

11. To deal with the unexpected

Life deals us some funny situations from time to time, as you may have already experienced. One has to be prepared to deal with such situations.

THE GUIDE TO PLANNING

Let us start.

Step 1

If you have a working financial plan, you should include retirement planning in that plan. Ideally, it helps to start early, but it can be difficult to convince someone in their 20s to plan for their retirement! Like any budget, you start planning your retirement budget by estimating your income and expenditure during your retired life. The most important estimate is how much your retirement expenses will be, both day-to-day expenses and big chunky investments.

All this is confusing !

Retirement planning sounds very intimidating to many people. However, like all long journeys, it begins with a small step. First, you need to accept that you will retire, and like all events in life the person who is better prepared will face it better. So, retirement planning can be made simple by breaking it into small steps.

It is very likely that you will buy at least one house, maybe two cars, white goods, tours and holidays, and need nursing and care during your retirement. Apart from these capital withdrawals, you will have to estimate the expenses on food, shelter and clothing as well.

How much you will spend in retirement is a function of your standard of living and how long you expect to live! If your parents (or grandparents) have been living to the ripe age of 90 years, chances are you will live to a 100!

Step 2

Make a realistic estimate of help that you may need for day-today living, including nursing, assisted living, old age home, inflation, un-insured medical expenses, medical insurance expenses. All these are what we call 'non-negotiable' expenses. Expenses such as travel, fun, eating out, and entertainment are 'discretionary' expenses, which can be avoided or delayed.

Step 3

Next, draw up your list of things you own and the amounts you owe. Estimating how much you really have is an excellent exercise, which you may or may not have done. This statement will tell you about all your assets and liabilities, and your 'net worth'.

Assets and Liabilities

When estimating your assets, ask yourself the following questions. What do you own? These include a home, property, gold, equity shares etc. Do you

have a nominee for all these assets? Is there a tax liability on a regular basis? Is the asset insured? How liquid or illiquid is it? When estimating your liabilities, check what liabilities are long term (due in more than 1 year), short term, secured, etc.

Cash Flows and Insurance

When estimating current and future cash flows ask yourself the following questions. What investments have a certain inflow? These could include annuity payments, pensions, interest from RBI bonds, NSCs, etc. What investments have a reasonably certain inflow? These could include dividends from blue chip companies. What investments have an uncertain inflow? These include dividends from not very high-quality companies.

When checking your insurance, do check the kind of insurance you have, its coverage and its usefulness after 20 years of inflation.

Will

This is an essential factor in retirement planning that ensures your wishes are carried out to the letter. Consider whether you want to leave some assets for your children or a charity, or earmark a certain amount for your children. Also, consider special needs – such as if you need to make a provision for a child or a sibling who cannot earn, and whom you are currently supporting.

Net Worth

Your net worth is the mathematical difference between your assets and liabilities. Many people forget to add the cash value of their life insurance, their provident fund, etc. in their net worth. Ensure that you include all your assets, and all your liabilities like home loan, car loan, personal loans, etc.

Step 4

The next step in retirement planning is to compare your income and expenses. There are 3 possibilities:

- Expenses = Income
- Expenses > Income
- Expenses < Income

Without getting into relative terms, Situations 1 and 2 are close to a disaster. And don't forget, if your expenses are only slightly lower than your income, then the demon called inflation will quickly bump you up from the third category to the first two categories. So, you are 'comfortable' only if your income is far higher than your expenses.

Your retirement life should be distributed into at least 4 parts, if not more. Let me explain. Let us assume you retire at 55 and live until the age of 95 years. Your lifestyle (and therefore your expenses and income) will be divided in 4 blocks as follows: 55 - 65, 65 - 75, 75 - 85 and 85 - 95. Once you have decided your 'blocks', estimate your 'retirement income'. From 55 to 65 years you may end up earning some amount by pursuing some activity – right from maintaining accounts for co-operative societies, to teaching in a coaching class, being on the Board of some companies, or doing part time consulting. Apart from this, you should identify any income you will have in retirement – pensions, as well as any rental, dividend, interest or other income.

Let's say you are not in the lucky few that are in Situation 3. If your expenses are high (a matter of fact, not of opinion) you need to reduce expenses dramatically. Hold on a second. You believe your expenses are not that high and that you can sustain it? Let's bring you up against reality.

Systematically withdrawing from your capital is something, which you should consider only after you and your spouse reach the age of 72 - 73. Until then you will have to live within your income. Or to put it better – you have to stay put in Situation 3.

Assume you have 3 meals a day and each meal on average costs about Rs. 150. Your food cost per person per day is Rs. 450 (150x3).

In retirement, your food costs will be Rs. 450 x 30 days x 12 months x 25 years = Rs. 40,50,000 per person. Only food costs for you and your spouse is Rs. 80 lakhs. This, after ignoring inflation!

What are the costs that you WILL incur in retirement?

Housing

Entertainment, medical, and more will come a close second. Housing is clearly a factor of the size of the house. Housing expenses can be split up into two segments: physical and financial. The physical will involve a maid, gardener, or cook and the financial will involve the upkeep including maintenance, electricity and tax costs. A big house costs much more to maintain than a small house. So if the birds have flown the nest, see if you can downsize the house – that will dramatically save you electricity, insurance, maintenance, society charges, etc.

Daily expenditure

For convenience, you should have one or two credit cards in your armoury. The trick is in how you use it, by not using the 'credit' part of the credit card. Use it more like a charge card. Credit obtained on a credit card is expensive and thus avoidable – for retirees it is a big No.

Monthly expenditure

Look at all the monthlies – they create quite a hole – on an annual basis. Do you need 2 landlines and 2 mobiles? What about the magazine subscription for a magazine you do not read? Or a Gym membership that was paid for until today by the company? Or a spare car? Do you need 3 servants? Just think and look hard. You will see the 'big' items and the 'small but recurring items'. Normally, the small but recurring expenses really hurt.

Estimating one's expenses is an art and a science. Remember to provide for buying one house, a few cars, a few white goods, medicines, entertainment. Just list the whole thing, put a number to it and find out whether it is realistic. If you have never maintained accounts for yourself, it might shock you.

Many books and articles will tell you some thumb rules such as "you will need 70% of your pre - retirement expenses" during your retirement. This figure is too general so it should be taken with a pinch of salt – instead you should be more detailed in your estimation. The advantage in doing this

exercise say 10 or 15 years in advance of your actual retirement is that you can delay the retirement if need be, change the place where you will stay post retirement, choose the size of the house, etc.

CHAPTER 4

Retirement and The Great Indian Family

CHAPTER

Retirement and The Great Indian Family 4

Food for thought:
Children:
how to broach retirement with parents
Parents:
why to broach retirement with the kids
Planning for those with special needs

A few years ago, something momentous occurred. The Reserve Bank of India (RBI) suspended Global Trust Bank's (GTB's) operations. A gentleman I know, S. Varadarajan, had his fixed deposits, savings account and demat account in GTB. He was a rich retiree; nevertheless, as soon as some of his relatives saw the news item flashing on the TV, they called and offered help. Three of his brothers sent him cheques and one brother sent cash – within 2 hours of the newsbreak.

"Families are like fudge – mostly sweet with a few nuts"
Unknown

However, his son (settled in the US) called to ask him whether he needed any money. Mr. Varadarajan decided to say 'no'.

One week later, the problem was resolved. GTB was taken over by a public sector bank and the accounts were once again active. Mr. Varadarajan met me after the issue was settled. He was upset with his son and felt his son should have just sent the money first and then asked whether it was needed.

The senior Mr. Varadarajan – to use his own words – said, “I did not ask him whether I should pay his college fees: similarly, he should have helped me without asking.”

> **The younger Mr. Varadarajan expressed, “my father should feel close enough to say – I want the money.”**
>
> **I know both of them, and they are not ‘money - crazy’ or obsessed about money.**

So what went wrong? Better yet, where am I going with this story? Communication. The father retired as a CEO of a small company. He says he could not ever get himself to ask his promoter for a hike in salary! Quite naturally, he felt awkward at the prospect of admitting to his own son the fact that he needed money. In real life situations, there are people too proud to accept (even to themselves) that they need to ‘ask’ somebody else for money. This is something his son failed to understand.

In spite of working in an era where people do not hesitate to ask for a raise from their employer within a year of performing well, he couldn’t understand what the fuss was all about.

The lesson? Knowing how to help is not easy, learn it.

Similarly, there is no shame in asking for help or acknowledging to yourself that you need some support, even temporary.

For children

In India, the second most taboo topic at the dining table is, of course, money. If you think you were nervous talking to your parents about your first date, see how nervous you get when you need to talk to your parents about their money and money management skills. This is more so if you are a family with many brothers and sisters, where you could be perceived as greedy for asking about inheritances.

You may have grown up, be cruising into middle age, have your own financial problems, and need to talk to your parents about their money. However, if you and your parents continue to shy away from the topic, the consequences could be enormous. It is so common for me to see asset rich and income poor parents with children who are income rich and asset poor! Rich old people in Mumbai and Delhi sit on properties worth a fortune, but have a very low income to support their lifestyle.

> **"Mom, I wish to talk to you about your finances" is a nice approach if you have a good communication line with your parents. Some parents are happy with such a frank approach. Many parents also take this approach, "We wish to pay for your daughter's education – can you tell us in what form you want it?"**

The best course of action is a frank and objective discussion about family finances as soon as possible. Some children may need some money or may have a surplus wondering what to do. So, even if your parents are still only in their early sixties you should have an idea of what they have and what help they need. How to approach this sticky topic is not for me to say – you know your parents better!

Sharing information about your estate planning – involving your children is a good way to bring 3 generations together! Asking them about the lawyer, accountant and broker that all of you can use, can be good icebreakers toward a more detailed discussion.

Of course, telling your parents "The medical insurance cover I have in office covers you for a limited purpose, are you interested?" is also a good conversation starter.

Parents are not very forthcoming about their financial position especially if they see an ulterior motive. Do not push. Be patient with them.

Remember that they were patient with you when they were bringing you up.

And be prepared for answers you may not want to hear. Parents, while dividing an asset, may not be fair – so be prepared for that. They may also not want to tell you about something they want to do for their relatives or their children.

What should you be talking to your parents about specifically?
The following tips might help:

1. They should not fall prey to financial pitches.
2. All investments should be held in 'anyone or survivor' mode.
3. They should always use phrases like "I like your scheme, but I will ask my son and get back to you" – useful whether they are buying a new phone connection, a mutual fund, a holiday package. This acts as an excuse to think and get back.
4. Parents and children should know where the important investment documents are kept/stored.
5. Meet all the advisors who deal with your parents – lawyers, chartered accountants, broker relationship managers, etc. and have all their contact numbers, so that you can get in touch with them, just in case.

For parents

Nobody likes to believe they are mortal. We all want to believe that we will live long enough to hold our great grandchildren and be a big happy family. Unfortunately, ground realities are harsh.

The current generation whom I meet is inheriting large amounts of money; this is partly because earlier generations were obsessed about saving and there weren't many avenues for spending unlike today.

However, these large inheritances are not large enough to warrant litigation if some of the inheritors are unhappy about the distribution. Note that these are not people who left a will, but felt that they brought up their children well enough to not squabble over money. That may be true or not, but the seeds of discord have already been sown.

I'm sure you subscribe to the same thinking. You are also putting off making a will because you feel it's an easy thing you can do tomorrow; just

download a Will (Google is so useful!), fill in the details and your will is ready. At the very best, you have made a will, but filled in details vaguely, hoping that your legatees will sort everything out.

Let me present you a few scenarios where not thinking through a will has made things go wrong; or even what happens when you don't make a will.

Scenario 1:
One child depriving the other children of their rightful share: I have seen this happen, especially if the other children did not know about the existence of the asset. The alternate scenario is that the siblings are magnanimous to let it go, or they are too old and weak to fight, or they are worried about 'money' affecting the relationship, etc. In case you wish to make sure that some of your children do not deprive the other children of the money, make sure you say it in your will, loudly!

Scenario 2:
Does this refrain sound familiar? "My brother is not even bothered about my father, I have to look after him, and so his house in Santacruz should belong to me." An excellent thought. But what the sister doesn't realize is that as soon as the sun rises after the father's funeral, the brother can go to court and claim 'undue influence'. Especially now that the flat is worth Rs. 1.7 crore! Although it sounds 'justified' and 'fair', giving all your assets to one child who took care of you may not be a great idea. Pay the 'caretaking' child a good salary: after all you will pay a full-time nurse, won't you!

Let us say you think your 'sacrificing daughter' deserves a salary of Rs. 30,000 a month that will amount to Rs. 360,000 a year; for 5 years, that will amount to only Rs. 18 lakh, not Rs. 1.7 crore!

Scenario 3:
Will my second wife leave all the assets to the children of my first wife? If you are into relationships of the TV serial kind or a simple second marriage, ensure that the children of the first wife, the first wife, the second wife, and the children of the second wife are not in any kind of a financial 'joint

relationship'. It does not work. Simple, but true. You need to separate them and your will has to reflect this.

Scenario 4:
Your son wants to move in with you to look after you. How noble! But after 3 months he asks to be made a joint owner in your property. You do not like it, but grudgingly you oblige, because your son is a noble kind-hearted man. Unfortunately, he had 'forgotten' to tell you that he is a guarantor to his 'artist' son's TV serial venture that ran aground 2 years back. Can the bank start chasing your property? You bet!

Scenario 5:
You spent Rs. 5 lakh on your son's education and Rs. 12 lakh on your daughter's wedding expenses. Your son wants to know how are you planning to leave the house to them 'equally' - after all, there was no equality while spending! So, he wants a bigger share in the inheritance.

Don't fret and fume, just communicate.

Scenario 6:
You think your 'qualified' son can do with a smaller inheritance than your daughter who married her high school sweetheart. Your son is doing very well for himself, likes his sister, but knows that his brother - in - law is a bum. Well, ask your son before you take any decision, he might think differently! He might legitimately say, "Look, give me more, because I will be there for my sister when she needs me," or say, "Are you punishing me for doing well in life by leaving your money to that bum!" Communicate with your children, do not assume.

Scenario 7:
You loaned Rs. 10 lakh to your son when he bought that penthouse, because he knew you had the money and you didn't mind loaning it. Now your son repaid in the first year very promptly, second year a little less promptly and in the third year only 8 cheques came. Now he is avoiding your calls! What do you do? If your relationship is important, face the situation. More importantly let the other children know it, and ensure that this loan is

mentioned in the will, because now dividing the rest of the assets equally is ironically unfair.

Apart from all this, as the head of the 'family' goes from being an earning person to a retired person, his status in the family may be diminished. The provider may become the beneficiary. Both, the younger members of the family and the retiree, should be sensitive to such changes.

> **I have enumerated only a few real-life scenarios and your circumstances may be unique. It is necessary that you consider a financial planner for deciding how your will should be made and then a lawyer to actually draft the same, especially if there are non-family beneficiaries. Some simple solutions include buying a life insurance policy early on in life and making the appropriate person the beneficiary.**

Beware of hangers on!

Retirees should also be aware of people around their lives who will make some claims when they see a lump sum amount – normally received at retirement. You should be firm and stand your ground, which may not be easy. This person could be your son, daughter, son - in - law or brother - in - law, so be careful. Some of them could bring a hare-brained business proposal. Just say no firmly.

Families with children with special needs

I now know of many families which are coping with retirement planning needs for their differentially able children. It is a huge challenge for sure.

Imagine a 65-year-old man with a 64-year-old wife and a 38-year-old child who is unable to earn a living, unable to do his own banking, and obviously cannot run his house. How does a parent provide for his RETIREMENT? The financial planning challenges for parents of special-needs children are very difficult and complex. One of the challenges for these parents is

planning for their own retirement, and balancing that with the long-term needs of a disabled child, who IS VERY LIKELY to outlive them.

It is a big challenge. Talk to the parents and they cannot go beyond school, college, some vocational courses – but nothing prepares them for a real long innings on their own. In the above case there is a chance that the child can live for nearly 20 years after the death of his parents.

Key challenges include creating a plan for the family member's care, projecting cash flow needs well into the future, appointing friends as caretakers, enrolling the siblings – and hope that the siblings outlive the challenged person, and making decisions about investment allocations for assets dedicated to the family member. And of course, create a huge, huge corpus that will provide for food, shelter and care till the person dies – and that could be at 90!

What are the main problems in executing this plan?

- Parents – for whatever reason – refuse to push a challenged child! In this case the son is capable of doing banking, investing, etc. but he has grown to be pampered and that means he does nothing.

- Sympathy in the young age leads to more pity and parents refusing to teach these kids anything.

- Even if they are taught, they are rarely pushed.

- Parents live in denial – and are not willing to come up with a written plan. I have given a written plan to a friend, and he refuses to ask his wife and son to participate in filling up the form.

- Parents fool themselves into believing that one day with rehab their kid will turn out to be fine. Some others keep fooling themselves into believing that somebody, someday, will take responsibility.

How to approach such scenarios?

Families with special-needs children should take a more conservative approach to asset allocation, with a higher level of cash than usual. You want growth and a nice, diversified portfolio, but there needs to be enough cash there that if the market falls and stays down for an inordinately long time, you need resources to meet immediate needs, and time for the portfolio to recover.

Buy adequate term insurance for the caretaker, and for the parent themselves – and leave clear instructions about how the money should be used to fund an annuity. An annuity without ROP may not be the greatest product, but in a situation where the child/adult cannot take financial decisions, an annuity is an awesome product.

Once you have made the plan share it with your other children, your siblings, and other extended family. Make sure that the CA and lawyer are also involved and do consider creating a trust and appointing trustees.

I can tell you one thing – it is not easy – but postponing it can only make it harder.

CHAPTER 5

Retirement And Insurance

CHAPTER

Retirement And Insurance 5

Food for thought:
Do you need insurance?
How the insurance will pay back
The many benefits of naming beneficiaries

Thanks to advertising and hard sales, everybody seems to have heard of life insurance. These ad campaigns have increased awareness about the need for insurance — life, auto, medical, etc.

One question I'm often asked is, "How much life insurance do I need?" Some people also ask, "Do I need life insurance at all?"

"You can be young without money
but you can't be old without it"
Tennessee Williams

I have found this quite difficult to answer unless the person asking the question tells me the full story. The 23-year-old daughter of billionaire parents does not need life insurance; however, a 23-year-old daughter who has an educational loan guaranteed by her father needs life insurance.

This question is so specific that trying to answer this on a website or with inadequate information sounds quite foolish and inadequate. I think you should spend considerable time in searching and finding a good financial

advisor. Look at it this way. Despite the presence of charlatans and quacks, we don't lose faith in doctors. For example, my portfolio manager is worth his weight in titanium.

However, you can use some guidelines when it comes to insurance — take only term insurance. All other types of insurance tie you to a poorly managed fund team which may not give you the best fund management skills — and you are tied to them for a 20-year life span. This is sub optimal and avoidable.

> ***When will term life insurance not pay?***
> Term life insurance will not pay out if you have lied about your health, such as smoking and drinking habits. So, telling a lie means cheating your dependants — it does not mean you are cheating your life insurance company.

Term policies are very easy to understand. In life insurance, the policy is clear — it pays on death. Clearly, the nominee will get a payment if you die; the policy covers only death, except suicide within one year of taking the policy.

However, not everybody needs life insurance. A 55-year-old widower whose children are educated and settled does not need life insurance. A non-earning housewife — on whom nobody is financially dependent — does not need life insurance. A student who is not earning does not need life insurance. So, if you are not earning, and nobody is financially dependent on you, you do not need life insurance. Life insurance is only necessary if, in the event of your death, people would be left in a financial soup without any income source. Thus, life insurance 'ensures cash flow continuance', not replacement of life!

The next question is for what length of time should my policy cover me? Well, if you are a parent — you need enough life cover until your children are settled. If you are a borrower, you need life insurance until your loan is repaid, be it a housing loan, car loan or business loan. Other than all this if

your life cover lets you sleep peacefully, you have enough cover. If you are a typical employee who will work until the age of 58 years, covering yourself until your age of 55 or the completion of your goals — whichever is later – is a good thumb rule.

This brings us to the next question — what amount should the life insurance cover?

This is an important question! Let us spend some time on this.

This question has to be answered in various ways. If you die tonight how much will be the income shortfall for your survivors? Do you have enough money (liquid) for them to meet their daily requirements? Do you have any personal, car or home loans? Do you have any business loans? Have you given any bank guarantees that might be invoked?

Firstly, what are the total expenses of the dependants? Simply put, how much money each year would your survivors need to maintain their standard of living? This isn't just simply replacing your income, but replacing your expenses. However, since they won't have your costs any more it has to be only the survivor's expenses. So, this figure tries to see how much will be the expenses of running your house, if you are not around. Remember to consider annual expenses such as festivals, clothes, house repairs, birthday parties, vacations, gifts, etc.

Secondly, for how long will this situation continue? If you have young children, it will be quite a while before they start earning. If you are just a couple with no kids, the wife may take up a job if she is not already holding one. You should discuss this over carefully so that you can take a realistic decision. However, if she is currently unemployed she may find it difficult to find one immediately. So, provide for 10 years' expenses — in case she cannot get a job, this extra cushion will be useful.

What are the other things to consider? Your funeral expenses and any special requirement — it could be an old promise to a charity or some friend's family that you are supporting.

And lastly, how much money do you have now? Remember the net worth statement you made? How many other life insurance policies do you already have? Will your family shift residence to a cheaper locality? Will they be forced to relocate?

Arrive at the shortfall, multiply by the number of years and reduce the amount that you already have. It is always better to aim at a higher figure than a smaller number — being conservative is better than being aggressive.

If at the end of the day your amount of life insurance helps you sleep better, you have arrived at the right figure!

Here is a letter that I wrote to a friend with whom I travelled from Pune to Mumbai.

Hi Ramesh,

It was a great trip to Pune. I always thought the drive would be great but the ride was scary, to say the least. It actually set me thinking about you and your risk-taking abilities. To summarize, you and your three brothers are the driving force behind the family business of tyre retreading.

When I reviewed your assets, I was impressed. However, when I saw the list of liabilities, I was struck by the lack of financial discipline — in your financial life, your business life and in your driving! Your new car is a fancy one, but constantly driving it at 170 kmph was reckless. I was scared, and Dr. Prakash was too polite to comment about your driving.

Let's enumerate your assets. You share your house with your nuclear family — your wife, two daughters and your younger son with your elder son in the UK studying to be an actuary.

Asset	Cost	Loan	Market Value
Home	Rs 3.6 crores	Rs 2.4 crores	Rs 4.5 crores
Car 1	Rs 28 lakhs	Rs 24 lakhs	Rs 18 lakhs
Car 2	Rs 18 lakhs	Rs 4 lakhs	Rs 8 lakhs
Car 3	Rs 14 lakhs	-	Rs 2 lakhs
Investment house	Rs 136 lakhs	Rs 120 lakhs	Rs 148 lakhs

Apart from these assets, you have a loan against property of Rs 30 lakh that you have taken for your son's education. His course has just begun and he will complete his education and start earning after 2 years. Your daughter will start her medical education next year, and she wants to do it in the US. That, adjusted for inflation will cost you Rs 1.5 crore, and your current level of investments — Rs 8 lakh in mutual funds — will be nowhere near sufficient. And I am not even talking about the amount of money that your twins will need when they pass the 12th standard — they are about six years away.

This set me thinking on your ability to comprehend and handle risk in your business and in real life. All the assets that you have are invested in your business and I know that the current level of borrowing in your business is also quite high. You have also guaranteed a Rs 14 crore term loan and a Rs 5 crore working capital loan.

Now, let us turn to the life insurance cover that you have. You have an endowment cover of Rs 10 lakh on which you are paying a premium of Rs 32,000 per annum. You have a life insurance cover of Rs 5 lakh (on your wife's life) for which you pay Rs 85,000 as a premium and a cover of Rs 5 lakh on your daughter's life, and a term insurance of Rs. 10 lakhs for your son.

Moreover, let us look at why you bought these policies.

Your father bought the first policy ten years ago to please the bank manager who sanctioned his working capital loan.

The life insurance policies on your wife and children were bought to please some 'deserving' cousin — whom you cannot trace now. The term policy on your son was done because the bank giving the education loan insisted on the same.

Thus, no life insurance of yours was bought as insurance. You only have insurance of assets, which are predominantly owned by the lenders — so your cars, your factory, your house, are all fully insured. Since nobody owns you, maybe you are not insured. If you are the asset creating all these minor assets, I am appalled that you are not insured.

I now wish to ask you the following questions:

Do you realise that your insurance is insufficient?

At your current level of insurance, on your death, your wife will not be able to keep the cars or the house.

When we did stock picking, why were you so careful, despite your risk-loving nature?

When we did pick stocks together, you were risk averse. Why do you flirt with risk in your real life, by driving so fast? You asked for the dividend history, quality of management, market leadership, return on capital employed, and so on. What has changed in your real life?

When I suggested term insurance, you scoffed at the idea saying that this money goes down the drain. My travel with you allowed me to do an exercise for the insurance you need.

Now let us look at how much insurance I think you need.

You need life insurance cover to repay all your loans — that amounts to Rs 3.8 crore. You need life insurance to cover all your children's education, which unadjusted for inflation is about Rs 4.5 crore.

You need life insurance to cover the personal guarantees that you and your brothers have given to the bankers, which is about Rs 19 crore. You need life

insurance to let your family spend about Rs 3.6 lakh per month — I am assuming that the annual vacations in India will be in five-star hotels and the foreign jaunts will continue. That means you need capital of about Rs 12 crore.

In sum, you need about Rs 38.5 crore of life insurance. Given your current cash flows, I suggest you get your brothers also insured for Rs 19 crore each — as a "key man" insurance in your private limited company — and take a Rs 18 crore insurance policy in your personal capacity. All of them should be term plans and for 15 years.

Does this look too high? Let us look at the cost of not having this insurance.

What will your family do if you died tonight?

- *Your son cannot complete his studies in the UK*
- *Your daughter too will have to forgo her MBBS course*
- *Your wife's boutique will close down*
- *The cars will be taken away by the lenders*
- *Your wife will shift to a one BHK rented accommodation and down scale the education plans of the younger kids*
- *Your brothers will not be able to pay her much money on a monthly basis — your salary may continue for say, two years, but what after that?*
- *Your brothers have no clue of the Dubai operations — they even do not know the local partner — so, your most profitable market will vanish.*
- *Your wife's policy and your children's policy will lapse because you will not be here to pay the premium.*

Weigh the term premium versus the cost of not having the policy.

I am sure you will understand.

Regards,
PVS

How to nominate in a life insurance policy?

Most people name their beneficiaries when they buy their insurance policy, and then never give the subject another thought.

That could be a mistake.

Good consultants recommend that you take the time to review your policy's beneficiary designations periodically (annually or whenever there is a birth, death, graduation, divorce, etc) and make sure they reflect your current needs, goals and circumstances.

Here are some things to consider; in India in most forms, **you can name the nominee and designation.**

However, like all simple things, it has some problems. One, it is rigid. If you identify your current children by name, and then have a third child later, that child will not share in the policy. Unless you revise your beneficiary designations, this youngest child will not share in the life insurance proceeds.

Also, if a named beneficiary dies before you, the beneficiary's heirs may be cut off from receiving proceeds.

Take a case where all your three children are married, and have children. In case one of your children should die before you, his/her spouse and kids receive nothing.

So, if you have a married child, ensure that the beneficiary designation is now changed to reflect the spouse and kids by name and designation. "Mr Suresh, my son, his spouse Mrs Lalitha Suresh and their daughter Ms Anuradha." This has more clarity than saying only "Mr Suresh".

Indicating individuals by name:
An example would be "Padmini, my wife, whose date of birth is 12 July 1977 and address is Plot 12, street 14, Guntur, and my children Ram, and Suresh". The advantage of such phraseology is that it is

simple, clear, and leaves no room for misunderstanding about whom you wish to nominate and give the money to.

Naming beneficiaries by the class or group

While making a will, you can use better language that will ensure omitting unintended beneficiaries by name. If beneficiaries are designated to be "all children of the insured," future children will automatically be included.

This can also be arranged so that proceeds are distributed as either per capita (based on a portion for each individual) or as a percentage per person.

Provided that you clearly identify the beneficiary designations, this may be the simplest and most effective method for naming beneficiaries. However, there can be disadvantages.

Things can become complicated if you have a complicated marriage. If you and your spouse have been married more than once and have children from both the marriages, you might have to be far more careful while naming the beneficiaries.

If you are not careful, the surviving spouse of your first wife may get all the money intended for the children from your first marriage, and that is not a comfortable thought! Don't be surprised. Stranger things have happened in real life.

Current tax position is easy on the estate

Currently, there's no estate duty in India. So, there is no share to be paid to the government of India, at least after your death. However, when you nominate someone, you may have to remember that a potential 30 per cent tax (if introduced any time) could reduce the amount of cash available to the nominee.

Naming an irrevocable trust as beneficiary

In case you wish to leave some money to a charity, you will still have to name a beneficiary with the clear instruction that the executor of the will

should pay the money to a trust. I have not seen Indian insurance companies accepting a trust as a nominee, but my experience is limited, and if any reader has a different experience, I will be delighted to hear about it. I see no practical reason why I cannot leave a portion of my money to a charitable or a religious organisation.

Advantages

Your children do not feel deprived — the money is not coming to them and then going to charity.

Disadvantages

Once the trust is established, you surrender all control over the trust and the policy, including the right to change the beneficiary. Since the trust is irrevocable, it cannot be altered once set up.

Final word on naming beneficiaries

Be aware that the decisions you make can have consequences that affect several generations for years to come. So, when it comes to naming your life insurance beneficiaries:

- Be as clear and specific as possible to avoid ambiguity and potential conflicts
- Review (and, if necessary, revise) your choices regularly, especially at times in your life when circumstances change — such as marriage, childbirth, divorce, career change, economic change, etc.
- Talk to your consultant to discuss the finer consequences of your decisions. The laws vary from country to country, so get specific recommendations from your legal and tax advisor before you act.

Post Retirement

Insurance plays an important role in life (and in death too!). Are you wondering what role can it play in your retired life?

We take insurance to cover various risks in our lives. Some risks, such as early death, are a serious risk for our dependants — so we take life insurance. Some other risks are critical illness, disability and medical illness. Most of these events put a great strain on your cash flows — in terms of loss of income and in terms of expenses that have to be incurred. So, we take

some insurance, which is for loss of income (critical illness, or disability insurance), and medical insurance (which pays for the expenses incurred).

Largely we insure to protect our assets and ensure cash flow to reduce the disappointment of losing an asset. Life insurance ensures cash availability to our dependants who are anyway missing us physically. If insurance is to ensure cash flow, what insurance is important for a retired person? This is a fair question to ask, isn't it? By the time we reach retirement, normally all our requirements have been provided for. So a critical illness, disablement or the death of a spouse should not require any 'insurance' except for the 'reimbursement' type i.e. medical insurance.

Apart from our bodies, we also carry insurance on our cars, houses and other assets. What we really do not insure is those risks which we feel we can carry on our own shoulders — mobile phone, television set, bicycle, etc.

Reimbursement kind of insurance is called 'indemnification' insurance, where you are indemnified for the expenses that you incur on medication/hospitalization.

What requirements will cease to exist once we retire? Asking this question is a good place to start.

After we retire, we will continue to live, eat, drive, and so we need home insurance, car insurance and medical insurance. However, the insurance that was supposed to replace the 'cash' that we brought in month after month is no longer necessary. The insurance that is a cash replacement — like critical illness, disability insurance, etc. are no longer required. There is a caveat though. If you have not finished providing for all your goals — like say daughter's education/marriage or spouse's retirement, you may need life insurance even after your retirement. The hope is that the life insurance will create an instant estate for the dependants, so that they can use the money to meet the unfulfilled goals.

The rules for continuing your life/critical illness/disability insurance post retirement could be the following:

1. Unfinished goals: if some/any of your goals are still not fulfilled, you need to have a backup plan. This could be in the form of a life insurance.

2. Not provided for spouse's retirement: you do not want her/him to have a lower standard of living after you die

3. You wish to create a large 'estate' for somebody you love.

   Re-look at medical insurance: for most people medical insurance is something that they are covered for only by a group insurance. This can be a fatal mistake. Whatever your age, you should take some life and medical insurance on your own and not depend only on the group insurance that your company provides. This is because if you are between jobs and something happens or you develop some illness, suddenly you may be uninsurable. So, even if you are 'young' by retirement standards go and get some basic medical insurance that will walk with you — and don't be dependent on your employer or some other group to which you belong.

CHAPTER 6

Women and Retirement

CHAPTER

Women and Retirement 6

Food for thought:
What stops women from planning?
How should they overcome the hurdles?

Women need to plan for their retirement more than men do – because they work for a lesser period and live longer.
However, they do have some major obstacles towards achieving this goal:

1. **They study less:** Academically women do better, but even in communities where education is important girls are not encouraged to study to their full potential. Do not get me wrong – they will go and do their MBBS, but then MS, MD or McH looks difficult because it takes too much time. 'How can we find a boy more educated in our community' is a question ALL GIRLS face – sad but true.
2. **As a corollary of studying less, they earn less:** If you assume that an average commerce graduate earns less than an average CA, applying the same logic, you know why women earn less.

'A woman's best protection is
a little money of her own.'
- Clare Booth Luce

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3. **Women do not take themselves seriously:** Many women say "Subra I am not the primary provider; my husband should do all this". Ladies, please rethink. If you know this is important, do it. Many men cannot

think beyond current consumption. It is women who think about the larger and longer implication things. I know many men would like their wives to get more involved, but women do not. Thankfully this is changing – but not fast enough.

4. **Women in the US work about 12 years less than their male counter parts –** In India the gap could be greater. Yes, we have seen Chanda Kochhar, Shikha Sharma, Ashu Suyash; but then these could very well be exceptions.
5. **Women take breaks:** Whether it is a child-bearing and child-rearing break or a break for nursing an ailing relative, it is the woman who takes the breaks. This again upsets her career, and therefore the earning cash flows.
6. **'Cooking is a woman's job and finance is a man's job':** Investing myth 101 refuses to go off! "My dad /husband handles my money," is an oft heard statement. Why? Ladies, if you can run a house, you can look after your money. Honestly, it might be the easier thing.
7. Not knowing where to invest, so doing nothing is a common characteristic of both men and women.
8. They love gold and treat gold consumption as gold investing. Stop fooling yourself. Gold ornaments will be of no use when you retire.

How to close the retirement gap?

- **Invest early and increase contribution rates –** Women feel that they should not put the 'wedding expenses' burden on their parents, so they tend to use up all their pre-marriage savings for their wedding. Parents should keep track of this and make sure that at the time of making the will, they give a sizable chunk to the daughter too. One important goal should be to contribute 20 percent of gross income into a retirement account. This can happen gradually and contributions can be marginally increased each year. They should keep tracking this on a regular basis. Women can use it like a parachute – in case their husband is not treating them well, they should be able to take this and fly off.

- **Ask for advice.** Many women feel insecure about managing finances. I am really saddened that the girls I know also do not so easily open up and ask for advice. I know a few girls who are (perhaps) being financially abused, but they have not chosen to ask me for help. It is really very difficult for a professional to broach a topic on the basis of 'assumptions'. A wealth management professional can help determine risk tolerance, investment documentation, insurance planning and how to invest money.

- **Leave PPF invested.** If you are giving up or suspending work due to family reasons, don't be in a hurry to cash out of your voluntary provident fund —this avoids taxes. Voluntary Provident fund can be rolled over to the next employer, or left with one employer for a longer time.

- **Do not be in a hurry to retire.** This may be painful and difficult, but could mean a great deal a few years from now. At 43 you might be weighed down by work, but at 53 you might be happy when your kids do not need you. Another amazingly great advantage – when your husband retires at least for a few years you don't have to see him all day – you could be at work. Don't sacrifice the future pleasure for the present.

Ladies, it's time to pick up and wear those metaphorical pants in your financial relationships!

SEGMENT II:
HOW TO PLAN RETIREMENT

CHAPTER 7

Planning begins at Home

CHAPTER

Planning begins at home 7

Food for thought:
• How to plan at every stage of life
• What are your spending buckets?

Children see money and how it is being used for various activities. They realize that cash comes from the ATM, and it is needed to pay for buying things, buying services, etc. As a parent it is our duty (since nobody else will) to teach them that money has to be earned, paid as taxes, saved, donated, and of course, invested.

If you do not teach your kid about money, who will? School and college, perhaps? Unfortunately, they don't.

Let us look at a person's relationship with money and the role of the family.

Stage 1: WHEN YOU FIRST SEE THE WORLD

Between 8 to 10 years of age, you start understanding money. You know the price of a house, a car, a loaf of bread and ice-cream. You know that your parents have had to slog to earn the money, provide for an adequate roof, put food on the table, pay your school fees, pay for vacations – and generally for the day to day living. By now you have been told that the ATM which spews money whenever you want has to be filled by the hard work that your parents put in at the office.

'Planning is bringing the future into the present so that you can do something about it now.'

By now you also realise that the servant who comes home or the driver who drives the car are providing you services. You also realise that money is in short supply and has to be rationed. If you have sensible parents, they talk to you about money responsibly. If they are not sensible, they fight over money. It is time when you compare the people around you – and start making money judgements. You know that a person with a bigger car, house, and vacations is considered rich!

At this point you are able to handle budgets and rationing of money. If you are told that you have a Diwali budget of Rs. 5000, you know that you can buy a dress for Rs. 4500 and Rs. 500 has to be spent on crackers! You have already asked for your first mobile phone and you did not like the budget of Rs. 8000 that your parents set for you. You have started realising the importance of budgeting, saving, etc. You are understanding words like inflation but are still too young to understand the implication of that word.

Stage 2: End of school to Completion of college education

You have finished school and wish to study further. You are now wondering who should be funding your education. Should you be taking a loan?

Should your parents support you?

Should your parents pay your full fee and board?

If they were to pay, how do you plan to repay the loan?

Stage 3: Beginning of earning life

The next stage is when you have just started earning. The questions that you have to answer are:

Should you live with your parents?

If you do live with them should you pay rent? How much?

Should your parents subsidize your higher education? Like an MBA costing Rs. 2 crores?

How about paying them for food and other services?

Are your parents subsidising your expenses?

Will you be able to afford to live on your own?

Who will pay for your wedding expenses?

How should your wedding be celebrated? – a simple court marriage or a full-blown Big Fat Indian Wedding?

Stage 4: You are buying some asset

Should you ask your parent to pay for a portion of that?

Should you take a loan for the asset?

Should your parent be a guarantor for the loan?

If you do take a loan from them will you pay interest? Will you repay the loan?

One sibling is milking the parent almost dry – will you interfere and stop (and risk your parents ire?)

Stage 5: Middle age, with grown up children in college

Do your parents need financial help?

Are they financially well off?

Do they need you to look after their finances?

Have their finances been well managed?

Are they in a position to comprehend the financial bombarding that must be happening?

Are they vulnerable to being cheated?

Do you need to forcibly look after their finances?

Do they have a will?

Are all their nominations in place?

The child parent relationship is not so simple. It has many implications. If your parents do not take care of their finances, YOU will have to take care of them in their old age. You cannot tell them "I told you so". It is far more complicated than an adviser-client relationship. So a parent not listening to the child or a child not listening to the parent are HUGE problems for the provider. Each parent is different and all parents know that each child is different.

> **When you handle money remember it has your parent's view, your view and your children's view. It is not easy to reconcile these three values. In fact, it is a process and you should start the process as soon as you understand these conflicts.**

The spending buckets!

We all know how to create wealth do we not? Spend less than what you earn. Save till it hurts. Invest wisely, insure adequately, track honestly – bingo, richness is all yours!

However, you may not know how this happens on a day to day basis. What do you do?

You make Budgets. Good old boring budgets. Now.

Ok. You hate making big elaborate budgets. Make simple ones! Split your 'outgoings' into 5 categories:

Compulsory payments: Mortgage payments, rent, car EMI, school fees, society charges – these are strictly not negotiable, especially in the short run.

Variable payments: Monthly groceries, food, clothing, hobbies, house hold expenses, eating out, some fun money etc

Save just to spend: Some savings to meet the annual payments – like life insurance premium, car insurance, festival expenses, and family wedding gifts. Some people can never seem to have money for such once in a while expenses. If you are one of them, create a recurring deposit, a series of fixed deposits, or keep in a liquid/short term debt plan.

Must meet short term goals: Your 4-year-old kid will go to school next year. His fees, the baby-sitter's expenses – providing the shortfall amount, car replacement expenses etc.

Must meet long term goals: Kids' education, buying a house, retirement, kids' weddings…be clear how much you are going to set up for each of these goals.

If you can classify all your cash flow into these heads, you will be able to manage your expenses better. You should allocate for 1, 3, 4 and 5. Once you do that, whatever is left is for 2. This is also called 'Paying Yourself First'.

You pay all the compulsory payments, retirement goals, children goals – the whole nine yards. After that you spend on your IMMEDIATE NEEDS. If need be, you downsize goals and assets.

CHAPTER 8

Retirement Goal Setting

CHAPTER

Retirement Goal Setting 8

Food for thought:
"It's nice to get out of the rat race, but you have to learn to get along with less cheese" - Gene Ferret

Like any destination, the Goal of Retirement' too be akin to the end of a journey- To start any journey one needs a map or a plan. Goal setting for retirement Should follow the best principles of Goal Setting.

To put it succinctly, goal setting should be SMART i.e. it should be:

- Specific
- Measurable
- Achievable
- Realistic
- Tracked

Let's look at each factor and start with Specific. The specific goal should be in physical terms/age. For example, you could say, "I want to retire at 55". However, retirement is a function of money rather than age. This means your retirement goal should actually read, "When my portfolio consisting of retirement assets is worth Rs. 2 crores, I will retire". Then, you could go about taking action towards retirement, by using the Retirement Goal calculator with a monthly investing ability of Rs. 33,000. When he came to me for his retirement planning, he was saving for his daughter's education (Rs. 18.000 per month), a foreign trips (Re. 12,000. per month) and Re. 3,000 for his retirement.

Retirement expenses calculator				
CATEGORY	**Current**	**Inflation factor**	**At time of Re-tirement**	**Comments**
INCOME				
Earned Income				
Interest Income				
Investment Income				
Miscellaneous Income				
Pension				
Income Subtotal				
TAXATION				
Income Tax				
Spendable Income				
EXPENSES				
HOME				
Mortgage or Rent				
Society- Charge				
Property Tax				
Home Repairs / Maintenance				
Home Improvement				
UTILITIES				
Electricity				
Water				
Telephone (Land Line, Cell)				
FOOD				
Groceries				
Eating Out, Lunches, Snacks				
FAMILY OBLIGATION				
Alimony				
Day Care, Baby sitting				
HEALTH AND MEDICAL				
Insurance (medical)				
Medical expenses				
Fitness (Yoga, Massage, Gym)				
TRANSPORTATION				

Car EMI				
Petrol				
Auto Repairs/ Maintenance				
Car Insurance				
Other (tolls, bus, taxi, tax)				
DEBT PAYMENT				
Credit Cards				
Housing EMI				
Other Loan				
ENTERTAINMENT				
Cable TV / Videos / Movies				
Net Connection				
Hobbies				
Magazines				
Vacation				
PETS				
Food				
Pet Maintenance				
CLOTHING				
INVESTMENTS SAVINGS				
80 C				
Mutual Funds				
Emergency Funds				
Savings				
MISCELLANEOUS				
Toiletries, Household Products				
Gifts / Donation				
Grooming				
Miscellaneous Expenses				
Total Investment and Expenses				
Surplus / Shortage (Spendable come minus expanses & Investment				

When we made a realistic calculation of his retirement requirements, he needed to invest Rs. 40,000 per month tar the next 15 years. At this stage, Rahul went through what I call an emotional upheaval — first, he was in denial and then he was angry! Once he had calmed down, we went through the calculations again, and he realized that the numbers didn't lie, there was very little choice, and he had to re-prioritize his goals requirement.

He quickly realized that if he tried to invest sequentially for his goals, retirement came at the bottom of the list. Taking a practical approach, he down sized his dreams for his daughter's education and marriage.

Retirement cannot be down sized, postponed or avoided! Even if one person were to die, the spouse may still have her/his goals, and retirement needs. This is the most important incentive to save/invest.

Rahul re-ranked his goal as follows:

1. Retirement (Rs. 24,000 per month)
2, Daughter's needs -(Rs. 9,000 per month)
3, Foreign trip (depending on annual bonus only)

Now Rahul and his wife are happier that they calculated the true costs and impact before they made a trip to Singapore. It was a natural consequence of Rahul's own prioritization.

Now, let's get to the next factor of Measure of goal setting. If you read the earlier example carefully, you will realize that all of Rahul's goals are now quantified and thus measured. Similarly, do write down your financial goals and match it against your financial life.

The next step to see is if your goal setting is Achievable. This means the goal should be within your reach. If you have set a goal of 'retiring at 48' and that looks difficult, you could, Reduce current expenses, Invest more, facilitated by reducing expenses, Downsize other goals, which will help you direct more money towards retirement, Retire later, subject to your health and company rules.

Doing these will make the goal more achievable and make it Realistic, which is the next step in goal setting.

- **Reduce current expenses**
- **Invest more, facilitated by reducing expenses**
- **Downsize other goals, which will help you direct more money towards retirement**
- **Retire later, subject to your health and company rules**

As the last step, comes Tracking your goals to ensure that your goals are fructifying.

Choose a portfolio tracker software or use a plain and simple excel sheet and track your goals to check if they are on the rails. The real life analogy is simple: If you were traveling by train you would occasionally keep a watch on the stations that you pass to ensure that you are going in the right direction, wouldn't you?

Therefore, for your retirement goal it is necessary to do the following:

- ✓ Set the goal
- ✓ Ensure that the goal is SMART
- ✓ Write down the goal. Unwritten goals are just dreams and written goals suddenly seem tangible
- ✓ Start investing
- ✓ Keep track

A few caveats

Be careful when you re-prioritize your goals, A bull run should not fool you into believing that the amount to be invested can be reduced while retaining the size of the goal. For example, if you started investing in the equity market when the market was in a bear phase, then a return of 10% p.a. looked difficult; however, in 2 years your portfolio was up 45% due to a bull run. At this stage, you may be tempted to reduce the amount you think you need to save invest for retirement, because you believe the returns will

more than make up the deficit amount. Be careful of this pitfall, as the markets can be unpredictable.

CHAPTER 9

How Much Money Do You Need to Retire?

CHAPTER

How Much Money Do You Need to Retire? 9

'What's the right time to hang up your boots?'

We all know when we should retire. When we have 'enough money to retire! Correct? Most of you would say yes. The only issue is what is 'enough'? To know how much is 'enough money to retire'; you need to know the following:

- How much money you have now
- At what age you want to retire
- What lifestyle you wish to support in retirement
- Where will you live in retirement
- Whom will you support other than your spouse
- Do you want to leave anything as your estate
- At what market fall level you lose your sleep
- How involved will your spouse be in your investment portfolio
- Are you willing to invest in learning before investing your money
- Will you 'learn'yourself or will you need an advisor

Now, let's assume your expenses:

- **Current day-to-day living expenses: Rs. 35,000 per month**
- **Inflation is estimated to be at 8% per annum. This means your expenses will double every 9 years. If you assume that inflation falls to 5% in your post-retirement life, you will need about Rs. 6 crores for retirement.**

It gets better, as this list is not exhaustive! Let's make it simpler for you by breaking it down to steps.

Step 1: Find out how much you have!

The first step is to add it all up. Make a list of what you own. Later, we will see what you owe.

The list of what you own should normally include financial investments, real estate, etc.This is what a typical list looks like:

- Mutual funds
- Equity shares, bonds, fixed deposits etc.
- Life insurance plans (the cash value of endowment plans)
- Pension plans
- Savings and current bank accounts
- Annuity commitments to receive (pensions)
- Gold and cash
- Dematerialization accounts and balances in brokerage accounts.

Houses, rent receivable, car, etc, will also figure in the list of assets. However, if you are using it for personal purposes, clearly these are not earning assets; it is an 'earning asset' if you have given your house or car on rent.

How much will you need for retiring is quite a difficult question to answer—so we can only estimate.

Let us make some assumptions:

- Your current age: 35 years
- Will retire at: 55 years
- Will live up to age: 85 years (30 years in retirement)

Now, let's assume your expenses:

- Current day-to-day living expenses: Rs. 35,000 per month
- Inflation is estimated to be at 8% per annum. This means your expenses will double every 9 years. If you assume that inflation falls to 5% in your post-retirement life, you will need about Rs. 6 crore for retirement.

You can use a few thumb rules to guide you — for example, according to Charles Schwab, the noted philanthropist, for every Rs. 1,000 per month that you will spend in retirement you will need Rs. 2.3 lakh. The other thumb rule that people use is to say you need 30 times your annual expenses at your retirement age. Say you spend Rs. 4 lakh a year at your retirement age — multiply that by 30 you get a figure of Rs. 1.2 crore (Rs. 12 million) as the corpus for retirement.

I have calculated the retirement corpus required for many people and most of them have tweaked their standard of living. Most discretionary expenses such as travel, which car to use, size of house, depend on the size of the corpus. Unlike Americans, most Indians under - spend during their retired life. It is very important to remember that once people lose their ability to earn they are very scared to spend. I believe that a person in employment is willing to spend Rs. 9 out of every Rs. 10 earned, but for a retired person it drops to Rs. 3 for every Rs. 10 earned. If you are a person who will be worried about 'unforeseen expenses' or longevity and spend less, please create a greater corpus than what is suggested by the numerous calculators available on Google! Here is one:

Net worth chart: Calculate your net worth with the help of this chart. If you do not know the details, get them!

Assets	Value (Rs.)
Current account	
Savings account	
Retirement plan balance	
Shares	
Bonds	
Debentures	
Mutual funds	
Annuities	
Precious metal/stones	
Life insurance cash value (Endowment policies)	
Art/ antiques	
Business/partnership	
Home	

Home furnishings	
Real estate	
Other	
1.	
2.	
3.	
4.	
5.	
Total assets	
Liabilities	
Housing loan	
Vehicle loan/s	
1.	
2.	
Other loans	
1.	
2.	
Taxes due	
Current bills outstanding	
Credit card outstanding	
Other	
1.	
2.	
Total liabilities	

Step 2: Estimate your retirement expenses

You may have paid off some expenses such as your children's education – but, you know your situation better than I do. Here is a worksheet of estimating expenses; make it as exhaustive as possible. Include national/international trips to attend marriages and get togethers, if you have a big extended family. In the next column, you need to adjust for inflation. As of today, 8-9% pa. is a safe number that most planners think is a good assumption. Of course, you can choose your number. Each expense head inflates at a different rate. Unbranded goods may inflate less than branded goods. It is also possible that if you use many services, inflation will be

higher than 10% p.a. Make it as exhaustive as possible– so that it can be more accurate

Retirement Expenses Calculator.

Category	Current	At Retirement Time	Inflation Assumed
INCOME:			
Earned Income	175000	5000	
Interest Income	10000	200000	
Investment Income	5000	100000	
Miscellaneous Income	.	0	
Pension	0		
Income Subtotal	190000	305000	
Taxation	20%	10%	
Income Taxes	38000	30500	

Spendable Income	**152000**	**274500**	
EXPENSES:			
HOME:			
Rent	0		
Society charges	2000	4,158	5%
Property Taxes	180	431	6%
Home Repairs/ Maintenance	500	1,821	9%
Home Improvements	1000	3.642	9%
UTILITIES :			
Electricity	2000	4,158	5%
Others	0	-	
Telephone (Land Line, Cell)	4000	6,232	3%
FOOD :			
Groceries	2500	6,898	7%
Eating Out, Lunches, Snacks	5000	20,886	10%
FAMILY OBLIGATIONS :	**5000**		
Alimony	0	-	
Day Care, Babysitting	4500	-	
HEALTH AND MEDICAL :			
Insurance (medical)	500	2,089	10%
Medical expenses	1000	5,474	12%
Fitness (Yoga, Massage, Gym)	6000	32,841	12%
TRANSPORTATION :			
Car EMI	15000	15,000	
Petrol	5000	13,795	7%
Auto Repairs/Maintenance	500	2,737	12%
Car Insurance	2750	8,723	8%
Other (tolls, bus, taxi, tax)	3000	16,421	12%
DEBT PAYMENTS :			

Credit Cards	0	-	
Housing EMI	19000		
Other Loans	0		
ENTERTAINMENT :			
Cable TV/Videos/Movies	0	-	
Net connection	2000	8,354	10%
Hobbies	1000	4,177	10%
Magazines	200	552	7%
Festivals	7000	29,241	10%
Vacations	25000	59,914	6%
Any other annual expenses	3000	10,927	9%
PETS :			
Food	0	-	
Pet maintenance (vet. etc.)	0	-	
CLOTHING :			
INVESTMENTS AND SAVINGS :			
80 C			
Mutual funds	1000		
Emergency Fund	0	-	
Savings	5000	-	
MISCELLANEOUS :			
Toiletries, Household Products	750	2,379	8%
Gifts/Donations	1000	3,172	8%
Grooming	1000	3,172	8%
Miscellaneous Expense	0	0	
Total Investments and Expenses	**121380**	**267,195**	
Surplus/Shortage (Spendable income minus expenses & investments)	**30620**	**7305**	

Step 3: Estimating your post-retirement income

Your post - retirement income has to be greater than your post retirement expenses! In Step 1, we have calculated your total assets and to what number it will grow by the time you retire.That list should be useful for you to estimate your non-earned income. Just remember to adjust for taxation.

The following worksheet will help you to get an idea of how much you would have to save today to live a comfortable retired life.

Retirement income goal:

Current annual income (A)	750000	
Percentage of income needed during retirement	100%	(guess)
Desired annual income in today's rupees (B)	750000	(guess)
Present sources of retirement income:		
Employer pension scheme	10,000	(estimate)
Personal pension fund	10,000	(estimate)
Income from real estate (rent/lease)	25,000	(second house)
Dividend income (shares/mutual funds)	2,000	(current figures)
Interest income (bonds/debentures)	10,000	(current figures)
Other income	500	
Current retirement income in today's rupees(C)	57,500	(total)
Amount to be funded from other savings each year [B — C] (D)	692,500	
Current retirement savings:		(earmarked exclusively for retirement)
Fixed deposits	500,000	
Other investments	1,500.000	
Total retirement savings	2,000,000	
Future value interest factor(r%, N years)	8%. 15 years	
Projected value of today's investments (E)	6,344,338	
Other contributions towards retirement:		
Annual future contributions (annuities)	100,000	

Future value annuity factor(r°/0, N years)	8%, 15 years	
Projected value of future savings (F)	2,715.211	
Estimated savings balance at retirement		
9,059,549		
Projected retirement savings (G)	9,059,549	
Approximate number of years your savings will last (G/D)	13	
r is assumed to be e%		
N is 15 years - this person is 15 years away from retirement		

Approximate number of years your savings will last (G/D)

Congratulations! You now know how much money you have, how much are your current expenses, and you have used these numbers to project your expenses in retirement. You also know how much money you will need as a corpus and you have a fair indication of how much income you can generate in retirement.

CHAPTER 10

Retire Rich by Investing Rs. 40 a day!

CHAPTER

Retire Rich by Investing Rs. 40 a day! 10

> ***'The secret to retirement may lie in Rs. 40/day.'***

When we think of accumulating a large amount of money, we trouble ourselves into believing that it takes a lot of money to create money. Well, it is not so. It is simpler. In fact, it is simpler than you could imagine.

While reading about investments, you may have heard of terms such as 'start early, invest regularly', or 'believe in tax - free compounding, and you will create wealth'. Well, if you have not, welcome to this chapter.

These are the things that are going to help you retire rich Retire Rich by Investing Rs. 40 a day!

Let me show you exactly how. Say you can set aside Rs. 40 every day for your retirement. Where do you get Rs. 40 a day? Why not cut down on those cigarettes? Then, let's see what could happen.

Let's also make some assumptions (do allow for the fact that all may not be valid). Let's also suppose that these are valid for the next 30 years.

Instrument	Yield (%pa)
PPF	8
Sensex	18
Equity	21

Money saved per day	Rs. 40	Rs. 80	Rs.120
Money saved per year	Rs. 14,600	Rs. 29,200	Rs. 43,800
Money earned if invested over the next 30 years			
Sensex	Rs. 11,547,841	Rs. 23,095,681	Rs. 34,643,522
Equity	Rs. 21,099,200	Rs. 42,198,399	Rs. 63,297,599
PPF	Rs. 16,53,935	Rs. 33,07,870	Rs. 49,61,805

Retirement Chart

Nice chunk of change, eh?! Doesn't that make your retirement look comfortable?

Of course, if you spend Rs. 120 per day on cigarettes, you probably won't live for 30 years! That still leaves your dependant spouse in need of a retirement corpus!

Ah, now you are saying you don't smoke? Maybe you're a frequent restaurant - hopper? That would easily mean Rs. 2,000 per week. Keep at it for 30 years and you would have said goodbye to Rs. 15 crore.

Money spent per week	Rs. 750	Rs. 1,500	Rs. 2,000
Money spent per year	Rs. 39,000	Rs. 78,000	Rs. 104,000
Money earned if invested over the next 30 years			
Sensex	Rs. 30,846,972	Rs. 61,693,943	Rs. 82,258,591
Equity	Rs. 56,360,876	Rs. 112,721,752	Rs. 150,295,669
PPF	Rs. 44,18,045	Rs. 88,36,090	Rs. 11,781,454

Gastronome's chart

Don't fit into the smoker or the gastronome's category? But you have one weakness -- you love shopping. Say, you spend about Rs. 10,000 per month on retail therapy.

Over 30 years, a Rs. 10,000 investment in an equity fund could fetch you Rs. 17 crore. I won't even go into what you can do with that kind of money!

Why do you think that otherwise smart and educated people do not appreciate this? Allow me to tell you what I think.

Money spent per month	Rs. 3,500	Rs. 5,000	Rs. 10,000
Money spent per year	Rs. 42,000	Rs. 60,000	Rs. 120,000
Money earned if invested over the next 30 years			
Sensex	Rs. 33,219,816	Rs. 47,456,879	Rs. 94,913,759
Equity	Rs. 56,360,876	Rs. 112,721,752	Rs. 150,295,669
PPF	Rs. 44,18,045	Rs. 88,36,090	Rs. 11,781,454

Your life is a function of your habits, not common sense. It's tough to change your habits. Consider this. Most smokers know the damage that 54,750 cigarettes can do to their health. But that 'one' cigarette never seems to matter. Ditto for that 'just one' cold drink or 'one' chocolate.

If you feel very defrosted reading this – and think your retirement corpus can come only from sacrifices let me add there are some other things that you can do. Switching off all electrical appliances when not in use, not racing the car while waiting, using CFL lights instead of tube lights, giving your monitor a break or using a lesser horsepower car - this is not 'depriving' you of anything. Just make those small changes in life and your Rs. 40 would be there available to be invested. Now I hope you are not feeling deprived!

Why don't people do this? It used to stun me until I heard, "It takes a complicated mind to think of simple things." Here is my explanation for the current state of affairs.

Most people don't care about small numbers and wait for that big amount to come by for them to save. Funny thing is, if I tell you saving (and investing) money is very simple and needs very simple

methods to make large amounts of money, most people, including you would laugh at me. Or people get into a denial mode – will equity markets give 21% return over the next 30 years? What about inflation? Well you can ask these questions till the cows come home. The truth is it is really easy.

It is really just so easy. Start small. Start simple. Save big! Then invest it. You do not need complicated tools such as day trading, brokerage accounts, futures and options, etc.

When you tell people that they can make a lot of money by being disciplined, they will just not believe it!

CHAPTER 11

Understanding Compounding

CHAPTER

Understanding Compounding 11

Food for thought:
• Why do you need compounding?
• How does it work?

Have you noticed how some good habits have an amazing compounding impact?

It could just be running 10 kilometres thrice a week. Not a very big task, but just imagine the impact that it has on your life.

Or the act of giving up sugar.

Or finishing your dinner by 8 p.m. and hitting the bed by 10 p.m. These are life-style changes - and the impact is seen over a long run. The problem for many of us is that we are worried that in the short run we will be judged by friends and family! Imagine not attending a single party because you need to be in bed by 10pm! However, the long-term results are worth it...

'Compound interest is the eighth wonder of the world. He who understands it earns it… he who doesn't, pays it.'
- Albert Einstein

One of those habits is the SIP - the systematic investment plan - a method of investing in a mutual fund (any asset actually). Have you noticed how some good habits have an amazing compounding impact?

However, many people who start a SIP in, say, April do a 12-month it which gets over in March of next year. Unless the adviser and the investor are diligent, the next SIP starts only in June of the next year - 2 months have been missed.

Today one amazing opportunity is available to you – do a SIP for 35 years and do it as a RISING SIP. You can choose how much the increase should be on an annual basis.

Like so many habits, the SIP habit has to be converted from a flat SIP (which is the previous chapter) to a rising SIP.

The advantage of forming good habits - eating, sleeping, exercising is NEVER felt on day 1. Yet, over a period of time it has an amazing impact.

So here are the numbers.
If you have a SIP of Rs. 10,000 for a period of 35 years, that amount growing at 12% p.a will grow to Rs. 5, 17, 99, 620.

Definitely not bad, considering that today most people starting their life can put aside Rs. 10,000 a month.

Now just increase the SIP amount by 10% a year. This grows to Rs. 14,81,83,096. Which is almost 3 times the amount that it becomes without the increase.

Now let us see how much does Rs. 10,000 a month become in 35 years at 18% p.a?

Well, it becomes Rs. 21,79,92,813.

Now how much does Rs. 10,000 a month become in 35 years at 18% p.a. with a 10% annual increase? Well it becomes Rs. 44,98,42,280!

So go and learn about increasing SIP on a perpetual basis.

When you start running, you run about 5 km as a starter. Then you grow to running 10 km at a time…well there are people who run 220 km races. Make your choice.

Compounding is a good habit. Whether in life or in investing. Make it perpetual and make it increasing at a rate of 10% p.a. That will build your retirement corpus!

CHAPTER 12

Compounding excellent, but not enough!

CHAPTER

Compounding excellent, but not enough! 12

Food for thought:
• Things to watch out for when compounding

One day we will lose it all.

Our friends, our hobbies, our siblings, our thinking, our faculties, our……and we had acquired this with years of compounding! Our wisdom, health…what you have all been acquired with lots of compounding. Even the Mountains, the sea, the ridges were all created by compounding…one day it could be lost.

'Take calculated risks.
That's quite different from being rash.'
- George Patton

So what does this mean? It just means that you SHOULD compound, with increasing amounts, but be careful that we do not lose it to one or two stupid moves. We do not get up one morning and say "I am going to destroy my wealth today". However, we choose to behave in such a way that we destroy wealth in a slow day to day basis. Think of AIG – it had 20 years of compounding growth at 21% p.a. Bear Sterns took 200 years of compounding to create a big great bank. Satyam, 20 years. Mafatlal group. Years of compounding, destroyed in a short time.

What does it have for you to learn?

Be careful about your behaviour! Understand risk. There are no ups and downs in the market – the ups and downs are in industries. Even in 2008 if you had bought Colgate, Hindustan Unilever Ltd. (HUL), Procter And Gamble (PnG), Asian Paints (yes 2008 peak) you would have still made a lot of money till 2017. What crashed in 2008 was Larsen and Toubro (LnT), Tata Power, Kotak, Cholamandalam…some of them have not yet hit the 2008 price even after 10 years of market recovery! Hence it was an infra collapse, not a market collapse.

The lessons of these examples are that we must diversify sufficiently, always on guard against the various threats that loom in the financial world as well as in our personal lives. Divorce for example, is a huge value destroyer. Remember to invest in relationships. From an investment angle, investors should look for businesses that are stable – a Procter And Gamble or Gillette maybe more stable than a Uber or Ola! These should at least be a little less subject to the natural destruct that we see in real life. Compounding is indeed the most powerful "shastra" at your command as you try to create wealth beyond meeting all your life's goals, whether it is to run a marathon, or accumulate a million dollars for retirement.

There are no end lines for you to reach. There is no prize for finishing.

Just as difficult as we labour to save and invest so that compounding can do its work, we must also be careful how we behave with our resources, making sure we nurture them accordingly, and manage them well.

CHAPTER 13

Retirement Strategy Statement

CHAPTER

Retirement Strategy Statement 13

Food for thought:
How complicated is it to make a retirement strategy statement

Once you have a written Retirement Goal statement — anything else is day dreaming — and you know what your retirement kitty size needs to be, it is time you created the roadmap of getting there. I call this the 'route' or the philosophy/strategic statement. This may be the 'guiding principles' of the investments that you have or will add, and keep you on the path during the journey.

How does one do that? Simple, you do that by making a deceptively simple little thing called 'Retirement Strategy Statement' or RSS. An RSS spells out an investors investment philosophy, asset-allocation targets, and expected results. It also lays out a plan for how the investor will monitor his or her portfolio.

'"What's the use of running if you are not on the right road"
- German proverb

Large organizations, fund managers and big investors create philosophy / strategy statements for their investment plans. Financial advisors craft them for their high-net-worth clients. You are no different and need one, too.

Why? Simply, because the RSS forces you to put your investment strategy in writing and commit to a disciplined investment plan. Even better, get a friend, wife, daughter, husband, neighbor, some third party to co - sign and monitor.

Here's what you should include in your statement, and a sample you can imitate. This is a hypothetical situation and person, Lavanya Krishnan. You will need to substitute your own goals, investment - selection criteria and expected outcomes.

Summarizing keeps you on track

The important elements of your RSS — your current assets, time horizon, expected return, tolerable losses, and portfolio benchmarks — appear at the start of your RSS in a summary format.

You'll come back to your Summary when you rebalance your portfolio.

Here is Lavanya's summary.

Current Assets: Lavanya has a total of Rs. 30 lakh in assets.

Time Horizon: With 16 years to retirement and an expected 30 years in retirement, Lavanya has a 46-year time horizon.

Overall Portfolio Expected Annual Return: Lavanya expects a portfolio return that is 4 percentage points above the rate of inflation.

Calculating your expected return can be tricky. I suggest that you come up with a return figure in excess of inflation. Inflation will vary over time, but it's the incremental return over inflation that is the most important determinant of whether you meet your goals.

As a guideline, here are the real annual returns (above inflation) that Lavanya expects:

- Large cap: 6.0%
- Mid/small-cap: 6.5%
- Index: 5%

- Bonds: 3.0%
- Bond funds: 3.25%

If you have a balanced portfolio, you'll have a blend of these returns based on your asset-allocation mix. If you are very conservative, choose numbers below these estimates. Conversely, if you are aggressive, adjust the numbers upward.

Loss Limit: Lavanya says she could accept losing 15% in any single year.

Over a five-year period, she could lose 3% annualized.

Your loss limit is the most you expect to lose over a specified time period given your tolerance for risk. So, in this case, Lavanya knows that she could lose 15% in any one year, and she's willing to accept that level of risk. Over a five-year period, she knows that she could lose 3%. If her portfolio fell by more than that, she'd have to re-examine her securities to see how she could cut back on her riskier holdings. Investors need to balance taking on risk in order to meet their goals with taking on too much risk and losing more than they can afford to.

Asset Allocation: Lavanya has set the following lower limits, targets, and upper limits for investment in each asset class.

Lavanya's Asset Allocation			
	Lower Limit (%)	Target (%)	Upper Limit (%)
Large-cap value shares	15	20	25
Large-cap growth shares	25	30	35
Mid/small-cap shares	15	20	25
Index shares	5	10	15
Bonds/FD/debentures	10	15	20
Cash	5	5	10

Rebalance when your portfolio exceeds the upper or lower limits.

Evaluation Benchmarks: For evaluation, Lavanya will compare the total return of each security to its category and expect it to be in the top 33% of its category over three and five years. She'll also check whether she is able to reach her goals.

Even if your investments fall short of your benchmarks, you may not want to sell them if they're still getting you to your goals. If that performance is enough to get you to your goal, you may not want to sell, even if most of the category is outperforming your fund or stock. In the end, it boils down to judgment.

Objectives

You have created a summary for your RSS; now, it's time to state your goals. What are you trying to accomplish, and in what time frame? Seeing your objectives in writing makes a lasting impact, and it comes in handy when it is time to rebalance. If you have multiple goals, here's the place to prioritize those objectives.

Here are Lavanya's objectives.

1. To retire in 16 years
2. To be able to spend Rs. 3 lakh per year, post-tax, during retirement
3. To make her assets last the rest of her lifetime

Investment philosophy

Jot down the basic investment theories that you believe in and plan to follow. Consider your ability to tolerate risk, your plan to balance risk and return, and any other principles you consider important to your long-term strategy.

Here is Lavanya's approach to investing.

1. Lavanya will balance taking on as much risk as she possibly can to achieve a higher long - term rate of return with her ability to tolerate that risk and not panic in a downturn and sell at the wrong time.
2. Recognizing that she will never know which asset class will outperform each year, Lavanya will diversify across a wide range of investment opportunities. Then she can participate in the upside of most asset -

class performance without over - concentrating in one area and risking a loss that she can't tolerate.

3. Lavanya will control costs by limiting expense ratios, fees, loads, brokerage costs and advisor's fees.
4. At 70, she hopes she will be able to shift all her money to a non - fluctuating investment such as RBI bonds so that she can sleep peacefully. However, this amount will have to take care of inflation, and last until her age of 81.

Preferences and constraints

Every investor has unique circumstances that influence his or her investment decisions. Write down any that apply to you.

Lavanya's preferences and constraints:
Time Horizon: Lavanya has a long time horizon — more than 10 years.

She can afford to tolerate short - term market fluctuations.

Asset - Class Preference: Lavanya believes in the concept of allocating her assets over a variety of sub-asset allocation categories. For example, within her stock allocation she'll hold large - cap value shares, large - cap growth shares, mid/small - cap shares, and perhaps international shares. She chooses not to use sector funds because she thinks their risks are more than she can tolerate.

Performance Expectations: Lavanya's goal is to beat inflation by 4% annually on an overall basis.

Tax Issues: Lavanya has significant capital gains in her equity portfolio. She will keep partially liquidating her portfolio regularly. This emanates from the fact that one can expect the capital gains tax, estate duty, dividend tax to be applicable in India over a 30-year period.

Risk Tolerance: Given that Lavanya has a long time horizon, she is willing to tolerate short-term market fluctuations of up to a 15% loss in any one

year. She wouldn't want to lose more than 3% over any five - year period, though.

As mentioned in the summary, if her portfolio fell by more than 15% in one year or 3% in five years, she'd have to re-examine her securities to see how she could cut back on the riskier holdings. Asset - Allocation Limits: Lavanya plans to have at least 5% in cash always, but never more than 10%. She would never want to have more than 25% of her assets in mid/small-cap shares nor more than 15% in international shares. Further, she'd never want to have less than 40% of her assets in large - cap shares. She would never want the combination of cash and bonds to be more than 30% of her portfolio. The international flavor is to be met by investing in mutual funds with an international exposure; however, the Indian portfolio will be through a combination of unit linked plans, mutual funds and direct equity.

These limits represent how much risk Lavanya is willing to take with her overall portfolio. Every asset class has an associated level of risk and expected return. The amount of assets you put in each category depends on how much volatility you can tolerate.

Investment selection criteria

Everyone should consider how they pick their investments.

There are practically unlimited options that you can check on many websites

Lavanya's investments must meet the following criteria:
Performance Consistency: All core funds must have consistently performed in the top third of their category for seven years (at this stage, it means no unit linked plans or ULIPs, but a small portion from the monies marked for international shares will be used here. Going forward, ULIPs will give way to international shares)

Performance Consistency: All core funds must have consistently performed in the top third of their category for seven years (at this stage, it means no unit linked plans or ULIPs, but a small portion from the monies

marked for international shares will be used here. Going forward, ULIPs will give way to international shares)

Expenses: Large - cap funds cannot have an expense ratio greater than 2.2%. Small- and mid - cap funds cannot have an expense ratio greater than 2.5%. International funds cannot have an expense ratio greater than 2.5%. Bond funds (other than high-yield bond funds) cannot have an expense ratio greater than 1%. High-yield bond funds cannot have an expense ratio greater than 1.25%.

Lavanya established these limits by calculating the average expense ratio in each category and then adjusting them upwards or downwards depending on the pool of available high - quality funds.

Style Purity: Funds must walk the talk. A blue chip fund cannot load itself with mid -cap or small - cap shares. Since rebalancing is what Lavanya wants to do herself, she does not like balanced funds.

Monitoring procedures

This section of the RSS is your blueprint of what to look at when you are rebalancing your portfolio. It forces you to think through your watch list and sell criteria.

Here are Lavanya's monitoring procedures:
Although Lavanya will review her portfolio performance on a quarterly basis, she will not make sell decisions more often than annually. At that time, she will not only review the returns of each of her investments against their peer groups, but she'll determine whether these investments are edging her toward her goals.

Qualitative Factors:
Once she has scanned the investment universe down to a pool of funds and shares that meet the above criteria, Lavanya will then rank the securities from highest to lowest by star rating. As a final selection, Lavanya will look beyond the numbers to qualitative factors. She will

read the Analyst Reports and visit the funds or company's Web site to see what more she can learn. The idea is to look beyond past performance.

Here are the questions Lavanya will ask about each investment:

- Has the allocation to the investment changed by more than the upper or lower boundaries outlined above? If so, consider selling some of the gains (and perhaps netting out some losses), or rebalancing within tax-deferred accounts.
- Did the overall portfolio beat inflation by 4%? If not, what changes are necessary to meet this criterion? Are performance expectations reasonable?
- Are there any changes to make due to a shortened time horizon?
- Were there losses in the portfolio? Were overall portfolio losses within the loss limits specified above? If not, which individual securities were responsible for the overall losses? Has anything fundamentally changed for these securities? Do we want to make a change?
- Are the securities in the top third of their peer groups over the past three-and five-year periods? If not, they should go on a watch list. It's not time to sell, but time to keep a close eye on future developments. If the security is on the watch list for more than two or three years, see if it is still meeting the long-term goals. If not, it's time to sell.

If she is contemplating selling a security, Lavanya will ask the following questions:

- Is the investment preventing me from achieving my goals?
- Does the impact of selling outweigh the opportunities of a new investment?

Now it's your turn

Use Lavanya's RSS as a guideline for your own RSS. Fill in your own expectations and criteria. Date it, sign it and lets revisit it in a year. It's the framework for analyzing your portfolio's performance — and for whether you are progressing as you ought, toward achieving your dreams. Remember, Lavanya could be a friend, client and a great soul, not necessarily in that order! She is a software marketing professional,

unmarried and staying with her parents who are fully provided for. The only insurance she has is a 4-year old endowment policy with critical illness. She has a house where she is living with her parents, and hopes to live in it during her retirement. If your circumstances are different, ensure your risk cover also becomes a part of your RSS.

CHAPTER 14

Investing for Retirement

CHAPTER

Investing for Retirement 14

Food for thought:
- The how of investing for beginners

Retirement marks the beginning of a new phase in an individual's life. It's a transition from a lifetime of work to a time when one can relax, spend time with the family and pursue other interests. Not only this, retirement also marks a transition in one's finances. With a regular stream of income no longer available, the savings made over one's working years now have to provide for all needs. When the pay cheque stops, your investments need to create a pay cheque for you. In other words, when you earn money you tend to run after money leaving the earned money to sleep in a savings bank account!

"Don't simply retire from something;
have something to retire to"
- Harry Emerson Fosdick

Given the kind of challenges that retirement can throw up, it isn't surprising that any financial planner worth his salt would recommend that retirement planning should be given its due importance and started as early as possible.

An early start helps! Even if the amount is small – let me prove it to you mathematically!

We will look at the issue of investing for retirement in 3 parts:

- **How much should you be investing?**
- **What are the appropriate instruments?**
- **What changes should you make during your investing life?**

How much should you be investing?

When it comes to saving and investing, people are obsessed with the returns they're going to get on their money. Whether it's debating the merits of a particular investment strategy, discussing the pros and cons of insurance, pensions and mutual funds (or increasingly unit - linked plans) or simply searching for the best interest rate on bank deposits, the returns dominate people's thinking. This is perhaps the main reason that people choose National Savings Certificates, PPF, and other 'guaranteed' return products.

This is perfectly correct, because, the better the returns you get, the more money you'll end up with. Two more factors determine how much money we end up with - the amount we put into our savings and investments in the first place and the amount of time we have it there. These two factors will have a far greater impact on how much money you end up with than mundane things like investment returns. For instance, let's suppose that you need to cobble together Rs. 5 crore over 40 years and you reckon on getting an investment return of 12% per year. If you pop the numbers into an excel file, you'll see that you have to save a paltry Rs. 3,980 per month.

Now imagine that you spend an extra ten years of your life on the spending mode and you find yourself with just 30 years to get your Rs. 5 crore together. At the same 12% per year investment return, you'll now have to save a difficult Rs. 14,000 per month. More than three times the monthly amount, although we've only taken 25% off our time period.

Putting in your own numbers:
Play with the calculators on www.moneycontrol.com with your own inputs. This will give you an idea of the numbers you should be looking at.

What if we did fancy getting that higher investment return, which would surely get us to our Rs. 5 crore over 20 years? Well, at Rs. 44,000 this is not really a breeze now. Well then, what about getting to Rs. 5 crore in 20 years with a smaller amount and a higher rate of return?

Wouldn't it? Well, of course, anything's possible, but to make up for the missed time, you'd have to almost double your investment returns. In fact, you would need to get a return of 21% per year to turn Rs. 14,000 into Rs. 5 crore in 20 years!

Finally, you'd need to account for your investing costs. If you're investing in the stock market via an index fund, then that might amount to 1% per year. If you're investing via an actively managed investment fund, then the charges might be more like 2.5%.

The long - term returns, after inflation, from the stock market tend to be quoted at anywhere from about 12% to 44% depending on time period and a few other things like how enterprising your fund adviser is! Any expectation (on current thinking) number that you hear above 16% is akin to fraud if suggested by your advisor, and foolish if you start to expect it.

So, for an efficient, indexing strategy, you'd want to be using a figure of 9% to 15%. So that 12% I was using is, if anything, fairly ambitious. It would certainly be easier to argue for a figure of 9% per year than 12% per year. But error on the side of conservative side is seen as healthy rather than erring on the aggressive side.

The long - term returns, after inflation and taxation, from gilts and cash are generally quoted as a little below 2% so, if you take away that 2% for average earnings growth you're left with not very much. As an illustration, to cobble together Rs. 4 lakh over 30 years with an investment return of 0%, you'd need to be saving Rs. 1,111.

With so little to play with, it's no accident that shares are considered better long-term investments than cash and gilts and it's no accident that low - cost cash tends to work best.

So, plug everything in... So, you should now have an investment return to aim for, an amount of money that you need to reach. All you need to do now is have a realistic guess at how many years you have until retirement, plug in the numbers and hey presto, it'll tell you how much you need to save.

...and repeat the process regularly

It's important to know that these calculations only tell you what to do, given certain assumptions. Those assumptions are guesses at best and they'll change regularly. The investment return you get might be different from predicted and the date of your retirement might get closer or further away. Most importantly, since we're saving money in today's money, we'll have to keep increasing the amount we save to take account of inflation and average earnings growth.

Let's go back to the original example where we were expecting a return of 12% per annum and aiming to collect Rs. 5 crore over 40 years. To do that, we set about saving Rs. 3980 per month. Now, let's fast - forward to 2023 (five years from the start) and look at two possible scenarios - one good and one not so good.

Scenario 1- Things go fine!

In the first scenario, we've actually managed an excellent investment return of 22% per year. That gives us a pot of investments of Rs. 4.5 lakh. The investment return is all the more impressive because we've only had inflation of 6%.

Plugging the numbers in (a final value of Rs. 5 crore, 35 years to get there, Rs. 4.5 lakhs already invested and a 12% annual return), we find we need to save Rs. 3,500 per month to get us there! That's a paltry fall of Rs. 480 per month! Although we have a cracking 22% per annum, the amount that we should be investing falls by such a small sum. Again keeping a conservative mindset you should not be reducing the amount that you invest – you are just providing for a goal, so until the goal is near, changes are not recommended.

Scenario 2 - Things go, not so well

In the second scenario, we've actually managed an investment return of 10% per year. That gives us a pot of investments worth Rs. 3.25 lakh. Again, inflation and earnings growth have amounted to 6%. Plugging in the numbers for this scenario (a final pot value of Rs. 5 crore, 35 years to get there, Rs. 3.25 lakh already available and a 12% annual return), we find that we need to put by Rs. 4,800 a month, again just a little more than what we have been investing so far. So really, have things become harder for us because of the poor investment return that we managed? No. Our income has gone up much more, so paying this extra Rs. 820 is now a breeze!

Should you increase the investment? Yes absolutely.

Either way, it's better than doing nothing

The gap between 22% and 10% is not small, is it? The impact is subdued because of the time frame that we are looking at – and the impact is marginal. Therefore, the rate of return, although important, is not the be all and end all of investing.

So, by repeating the sums on a regular basis, you can adjust your rate of investing to account for changing circumstances and how well your investments have actually done. Ideally, you should probably refresh the rate at which you're adding to your savings and investments on a yearly basis. Both these alternatives have given us a return far in excess of a money market fund or any debt instrument currently in force in the country.

What you can learn from both the above scenarios is the importance of starting early. Where things had worked well for the first five years, you'd be left looking to invest Rs. 3,500 per month. Where things had gone badly, you'd be left saving Rs. 4,800.

If you hadn't started saving at all, though, you'd be left needing to save an unlikely looking Rs. 7,650 per month. So, get investing now!

What instruments should you choose?

Depending on when you start, you could choose instruments with a

combination of equity and debt. Assuming you are young, you will choose a lot more of equity and as you get older, you should shift to less volatile assets like debt.

The choice would be largely equity mutual funds – more large - cap, some mid-cap and a very small portion of small - cap or focused funds. You should also look at unit-linked products, provided you can find products with less than 1.5% asset management charges.

If you decide to earmark funds just for retirement, I would recommend that you do this only after you are about 35 years old. At this age, you could choose pension plans from mutual funds, life insurance companies or the National Pension Scheme.

The reason for this is simple. Pension plans are designed to penalize withdrawals. For e.g. in a Templeton India Pension Plan, withdrawals attract a 3% withdrawal penalty. In the National Pension Scheme, a withdrawal is simply not permitted. In a unit linked pension plan – all the money that is withdrawn is just added to your income and taxed at normal rates. So, if you are disciplined do not earmark your investments exclusively for retirement at a young age.

What should you look for while investing for retirement?

Apart from run of the mill aspects such as safety, liquidity, and so on that one looks for in all investments in retirement, one should look for a very important feature – both husband and wife should understand the way the asset operates. The investments should be in 'Anyone or Survivor' mode (only with spouse). Once one spouse dies, it should be in a single name with the children as a nominee. This creates lesser hassles for the surviving spouse and enables an easy retired life as well.

CHAPTER 15

Retirement Instruments

CHAPTER

Retirement Instruments 15

Food for thought:
- What retirement instruments to use?

Investing for retirement (which is called investing in the accumulation phase) and investing during retirement (many of us will be investing even after we retire) can be as different as chalk and cheese. In the first stage, we are looking for growth and safety. In the second stage, we look for liquidity, current income and some moderate growth (to offset inflation).

There are various stages of investing too, and we are talking only about retirement investing here. In your early stages of life (some of you may be lucky enough to start investing in your 20s, but largely retirement investment starts in the 30s – say 32 - 34 years of age.

"When I was young I thought that money was the most important thing in life; now that I am old I know that it is" - Oscar Wilde

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In your 30s, your retirement is at least 20 years away, which means you can concentrate on equity - based instruments (such as ELSS, other equity mutual funds, unit linked plans with a higher allocation to equities, direct equities and the like).

As you age, you can and should reduce your exposure to equity. However, once you reach the age of say 70 you should completely exit from equity

other than an index fund. Other forms of equity involve some active management, while the index fund does not. So, all the need for equity (say 30%) should be met by only one instrument – the large - cap index fund (in the current context, this would refer to a Sensex or Nifty fund).

What happens to your investments post retirement? It is the time to shift from a largely equity portfolio to a debt portfolio.

Post - retirement investments are likely to be in various stages. Stage 1 could be from age 55 years to age 65 years. During this time, there may be some income coming in from some commercial activity.

The second stage could be from age 65 years to age 75 years. Here, the income is mostly from investments, expenses have reduced and the travel is no longer enjoyable! At this stage, expenses have come down in most cases, except for medical expenses. It is a time when the need to 'think' about investments should be reduced dramatically. A good portfolio at this stage should be index funds and RBI Bonds other than bank fixed deposits.

Stage Three could be from age 75 years to age 85 years. At this stage you do not wish to be very active in your investments – it has to be simple investments like bank fixed deposits. The advantage is you are not really worried about things like inflation. So, you can steadily exit from your index funds as well.

Investing after you have retired is very different from investing when you are young and are investing for retirement.

When you are young and saving for retirement you can (and perhaps must) invest money in highly variable asset classes like equities and real estate.

Once you have retired, you should be concerned with the following:

1. Will my money last longer than me and my spouse?
2. Will I be protected against inflation?
3. Will I have the liquidity when I need it?

These are 3 legitimate questions for a 55 - 75 year old. Once a person reaches 75 years of age Question 2 (inflation) ceases to be a worry.

Retirees have some other concerns:

1. What is a safe amount that I can withdraw on a regular basis?
2. Will I leave anything for the next of kin?
3. If I will surely leave something, should I distribute it when they need or only at the end of my life?
4. If I do a reverse mortgage, am I putting my net worth at risk?
5. Is there a tax implication for my children who are inheriting it?

However, there is another (often ignored) set of retiree investors. These are individuals who are already retired and need to start investing now. For such investors, capital protection and liquidity are priorities. In this section, we profile some investment avenues that retirees can consider adding to their portfolios.

Senior Citizens Savings Scheme (SCSS)

SCSS is an investment avenue meant exclusively for senior citizens. **The scheme defines senior citizens as those who are above 60 years of age; subject to the fulfilment of certain conditions, individuals who have crossed 55 years of age and retired under the voluntary retirement scheme can also participate in the scheme.** The minimum and maximum investment amounts are Rs. 1,000 and Rs. 15 lakhs, respectively. This scheme runs over a period of 5 years and offers a return of 8.5% p.a.

Liquidity

Interest is paid out on a quarterly basis on March 31, June 30, September 30 and December 31. Investors are also allowed to prematurely liquidate their investment at any time after some time, by paying a penalty in the form of loss of amount invested.

Taxation

Investments in the scheme are eligible for tax benefits under Section 80C of the Income Tax Act. Interest income is taxable and subject to tax deduction at source (TDS). Investors whose taxable liability for the

financial year is nil, can avoid TDS by furnishing a declaration in the appropriate form.

Post Office Monthly Income Scheme (POMIS)

For getting a regular income, POMIS is another investment avenue that retirees can consider. POMIS is operated from post offices and offers an assured monthly income. The minimum investment amount is Rs. 1,500 and the maximum amounts are Rs. 4.5 lakh and Rs. 9 lakh for single and joint accounts, respectively. The scheme runs over a 6 - year period and offers a return of 7.3% p.a.

POMIS Liquidity

POMIS fares well on the liquidity front. Apart from the monthly interest payouts, premature withdrawals are permitted after 1 year from the date of investment subject to a penalty. Interest income is taxable.

Post Office Time Deposit (POTD)

POTD is a fixed deposit from the small savings segment.

Investors can invest a minimum of Rs. 200. Investors can opt for 1 to 5 - year POTDs. The returns range from 6.6% p.a. (for the 1- year POTD) to 7.40% p.a. (for the 5 - year POTD) on a quarterly compounding basis.

POTD Liquidity

Premature withdrawals are permitted after 6 months from the date of deposit; however, the same entails bearing a penalty in the form of loss of interest.

Taxation

Investments in 5 - year deposits are eligible for tax benefits under Section 80C of the Income Tax Act. The interest paid is taxable.

Fixed deposits

One attractive investment option for retirees is fixed deposits. They offer assured returns, but the interest payout is done at an interval chosen by the investor. While looking for a debt instrument, safety of principal should be far more important than ‘returns’ so choose AAA or an equivalent rated, as it signifies the highest degree of safety. Also, some names such as Tata Sons

evoke a lot of confidence – so even if it means getting a little less interest it generates a lot of attention among investors. Most fixed deposits offer a higher interest rate to senior citizens, making it more attractive for them. Liquidity is not really a great factor, but possible. The interest income is taxable.

Monthly Income Plans (MIPs) of mutual funds

MIPs and Fixed Maturity Plans (FMPs) are investment avenues from the mutual funds segment. **MIPs and FMPs are market-linked in nature; hence, they do not offer assured returns.**

MIPs invest between 10% - 20% of their corpus in equities while the balance is invested in debt instruments. Investors can choose between the dividend and the growth options. There is no guarantee of capital preservation.

FMPs invest in debt instruments and target a pre-defined return. To achieve this, they lock - in the same at the time of investing and stay invested until maturity.

Withdrawal rate

The amount a person can withdraw on a regular basis is called a withdrawal rate- it is how much a person can withdraw from a portfolio for day-to-day expenses. Obviously, the withdrawal rate has to be less than the earning rate (post tax) until you reach an age when you can afford to touch your principal. **Once you start withdrawing from your principal, the amount of withdrawal becomes a function of whether the market is in a bull phase or in a bear phase.**

What should investors do?

Retirees can consider adding any one or more of the above investment avenues to their investment portfolios based on their needs. Also, the above list is not an exhaustive one. For instance, a retiree who has a regular income should consider investing a small portion of his money in index equity funds. It might be prudent to use the services of a good financial planner – if you can find one whom you can trust fully.

Withdrawal rate can be either a percentage or a fixed amount adjusted to inflation. For example, a person with a corpus of say Rs. 1 crore and having an annual expense of Rs. 6 lakh per annum will want to withdraw 6% of the corpus. On paper, this looks fine; however, inflation will play havoc by the time this person is say 65 years of age.

What are the causes of concern?

1. Fixed amounts withdrawn may not meet inflation adjusted expenses.
2. Risk of living too long. Theoretically, a person retiring at 58 can live for another 30 years; 35 years if the spouse is 5 years younger.
3. Inflation, taxes and asset management costs are all a drag on the portfolio.
4. Non-insurable health expenses.
5. Sudden fund requirements of children and siblings may be difficult to turn down.

Thumb rules and old withdrawal rules may be difficult to follow in the dynamic world of today. However, a rate of 4-5% of the corpus seems to be a good starting point. Making simplistic assumptions that if your corpus grows at 10% and you are withdrawing 5%, on an average you are fine. This ignores the fact that the equity portion of the corpus can grow at 12% average – but can also have high returns of 46% and low returns of - 32%. Such a high standard deviation can have a devastating effect on your portfolio.

Retirement portfolio planning is one of the most difficult things for a person to do. Risk is now defined as follows:

- Will I get my money when I need it?
- Will it get wiped out?
- Will I outlive my capital?
- Will the returns that I get be sufficient to combat inflation?

Welcome to all the answers!

To answer the first question, you have to structure and plan your portfolio in such a way that there should be some liquidity. Similarly, to answer the remaining questions, salt away some money in capital protected assets (such as senior citizens plan in post offices and RBI bonds). Whether you outlive your capital depends on how long you live, what are your expenses and if you do some unexpected withdrawals. Returns are a function of market returns, composition of the portfolio and so on. See a few case studies in the later chapters to understand this better.

CHAPTER 16

Personal Finance Ratios: Will they work?

CHAPTER

Personal Finance Ratios: Will they work? 16

Food for thought:
• What are financial ratios?
• Which ones to benchmark against?

Ratios help us with some shortcuts to remember and aim for. Ratios also help us compare across individuals and organisations of different sizes. However, personal finance ratios have to be applied carefully. A person earning Rs. 100,000 a year is different from a person earning Rs. 25,00,000. So use these ratios to see how far along you are. There are no prizes for getting it right, but getting it wrong may be a mistake you oversee and pay for later. Just calculate the ratios and see if these ratios are near what you think they should be.

'If you want to reap financial benefits,
you have to sow financially.'
- Joel Osteen

Let us look at the ratios.

Budgeting Ratio: 20-30-50 ratio. Says out of your Net take-home salary, save 20%, the MAXIMUM that you spend on housing should be 30% and the balance 50% you spend on everything else. Which means if a person has a take-home salary of Rs. 100,000 per month, he pays Rs. 30,000 as EMI / society charges / etc. and Rs. 50,000 on other expenses like food, clothing, vacation, etc. Sounds good? What happens to a person earning, say, Rs. 20,000 per month? Will he be able to save Rs. 4000 in some form?

He should spend only Rs. 6000 on rent (buying and EMI of Rs. 6000 is almost impossible to think of), and spend only Rs. 10,000 on food. Possible?

6X the monthly expenses is the Emergency Fund: If your monthly expenses are Rs. 40,000 and you are paying a car EMI of Rs. 8500 and a house EMI of Rs. 45,000, you need 93,500*6 = approximately Rs. 5,50,000.

10X of the annual expenses is the amount of Term Life Insurance that you need. This is too much of a simplification, but to avoid complicating the explanation, we will accept it as it is.

100 Minus Your Age – Investing Ratio: When you are building your investment portfolio, you need to do some asset allocation. There is no clear rule, however, one of the old rules is 100 minus your age should be invested in equities. These days as longevity increases, this 100 is being changed to 110, 120 and so on! Americans claim that this ratio works very well.

Limit Mortgage to 2.5X Your Income – Mortgage Ratio: This is another ratio that's built off a basic premise – you should spend less than 30% of your take-home pay on housing. If you make Rs. 12,00,000 a year, this means your mortgage shouldn't be greater than Rs. 30,00,000. If you put a 20% down payment, that's a house worth Rs. 37,50,000. If you want more house, you need to come up with a bigger down payment.

If you're 40, you should have 60% of your investment assets in shares and 40% in bonds. As you age, the allocation will shift from equities to bonds. If you feel that you're more of a risk-taking person, you can use the 120 Minus Your Age ratio.

Why does this ratio work? It's simple and it'll STOP you from over thinking and worrying and start investing.

Save 35X Your Retirement Year Expenses – Retirement Savings Ratio: How much money do you need to save into a nest egg (retirement basket) to retire? Experts believe that a safe withdrawal rate in retirement is about 5% of your assets (the Americans think it is 4%). By withdrawing just 5% a year, it's likely that your retirement funds will last as long as you do. Other way to look at it is to say that you will live till 90, and you have the corpus on the day you retire.

Why does this ratio work? It relies on the safe withdrawal rate of 5% and conservatively relies on your expense being the benchmark. The biggest challenge in retirement savings is getting people to INVEST smartly and target a REAL RETURN. With the 30X Your Current Expense a starting point and 100 Minus Age allocation rule for where to put your money, you eliminate guess work. As time goes by, you can make necessary changes.

Age X Pre-tax Income / 10 – Net Worth Ratio: This ratio comes from the bestselling book "The Millionaire Next Door."

I am a little iffy on age as a factor in any financial equation. A 25-year old medical student and 25-year old auto driver are on different income earning trajectories, and therefore, at the age of 25, the auto driver will have a higher net worth. He will probably have a higher net worth at 30 too, but from 45 onward the doctor and his higher earning power will outpace the auto driver! However, it is a good number to target, like the earlier ratios 1-6.

Why does this ratio work? Net worth is a very, very important metric to use, and the day you use this metric, you have arrived in the world of investing. This ratio works because it's a reasonable target.

All ratios work. Get your data and see how these ratios work for you. It is easy to communicate to your family in terms of ratios than absolute numbers. For example, you could create a "Retirement Portfolio" and tell your wife "the minute you think this has 35x our annual expenses, I can retire." Targets with ratios are easy to set –for children or for even your parents, spouse, etc.

Go on, give it a try!

CHAPTER 17

Monitoring Retirement Accumulation

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Monitoring Retirement Accumulation 17

Food for thought:
• Why monitor the corpus?

Accumulating a corpus for retirement is difficult. The reasons are not difficult to seek – not really knowing how much you need, not knowing the returns that you will get, how long will you live, how much will the returns be after x years etc. However, let us assume that this couple aged 34 years have figured out that they need Rs. 10 crores for their retirement at the age of 60 years.

'Balancing your money is the key to having enough.'
- Elizabeth Warren

Currently this couple has Rs. 10 Lakhs earmarked for retirement. Not a big number, but they have time. So what is their funded Retirement Ratio? It is 10 lacs/10 crore = 1%. The best thing for this couple now is to monitor this "Funded Retirement Ratio" and track it through thick and thin over the next 25 working years. Whenever they get a lumpsum gift or bonus, they can decide to spend, repay some loans or beef up the ratio.

This couple is saving about Rs. 30,000 per month for Retirement and are also paying Rs. 190,000 per month as EMI for their aggressive home loan. They are confident of upping their retirement contribution as soon as they repay the housing loan. As the couple in the example above makes ongoing contributions over time, increasing the account balance, the funded ratio

will keep increasing. In fact, even if no contributions are made, this funded ratio should still rise over time, simply given the growth in the portfolio itself, and by just 'not removing' the ratio will improve.

The virtue of this approach, though, is that instead of talking in terms of absolute numbers – which don't make you feel responsible to a goal – the funded ratio gives a good sense of progress. Most people's goals – aren't easily conducive to calculating progress. While it might be relatively easy to find out that Rs. 3,50,00,000 out of a Rs100,00,000 goal is 35% progress, most people can't calculate in their head that if their retirement goal is actually Rs 1.35 Cr, that it takes about Rs 4,750,000 to get to the same 35% funded ratio.

The funded ratio also helps put market volatility into context. It stops you from just looking at the rupee magnitude of a bear market decline, or the percentage draw-down, and relates it back directly to the goal. So if you had reached 35% of the goal in say 2022, and the market falls by 10%, you do not have to worry about the 7000 point fall, if your retirement funded ratio is down to just 32%. So it helps put lots of things in perspective.

It has a limitation too. The impact of compounding is DRAMATIC towards the later stages – so if you require 10 crores at the age of 60, at your age of 50, you may have reached only 36%. This might scare you. You should not be scared even if it is just 30% at age 50. It is the last few years when your contribution, and the power of compounding will both kick in. Again that gives you a good perspective. If at age 57 you have reached your GOAL, you can re-allocate to an even less volatile asset allocation!

CHAPTER 18

The Annuity - Withdrawing during Retirement

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The Annuity - Withdrawing during Retirement 18

So, you have retired! You have accumulated a nice corpus and you are looking forward to a nice simple retirement. And do you think like Gene Perret with these questions plaguing you?

1. Do I need to continue my life insurance, medical insurance and critical care insurance?
2. Will my company pension be sufficient?
3. How much can I withdraw from my principal?
4. What if I live to the age of 93? Will my corpus last?
5. At what age can I afford to touch my principal amount?

Is Rs. 50 lakh adequate enough to retire? Or is Rs. 1 crore adequate? Do I need to look at annuities to answer all these questions?

**"It's nice to get out of the rat race,
but you have to learn to get along with less cheese" -
Gene Perret**

First, let's examine the word 'adequate' and then look at annuities. Rs. 1 crore should give you an immediate annuity of Rs. 500,000 per annum – this is subject to the prevailing Income tax. Assuming a tax rate of 10%, it will leave you with Rs. 4.5 lakh – approximately Rs. 37,500 per month. This looks like a nice round sum and will look sufficient if you forget the villain called inflation.

So even for people who have accumulated Rs. 1 crore – words like inflation, taxes and sudden uninsured medical bills can sound dangerous. So, Rs. 1 crore may not be a safe harbor anymore!

The current economic scenario in the world cannot be just wished away so simply; it could last longer than you think, and the markets could go much lower before it gets higher.

A more conservative approach:
Trying to guess a 'safe' harbor with withdrawal rates over the next 30 years is difficult to say the least. We will go from being a developing country to being a developed country, worrying about inflation to worrying about deflation, having a large young population to a large retired population. The financial implication of all these changes will affect the 'safe' withdrawal rate.

Every retiree's goal should be to live off a retirement portfolio comfortably, without drawing down the principal balance to a dangerously low level. Unfortunately, India does not have any research about how much of your total portfolio you can spend each year and still enable your portfolio to generate an adequate annual income!

Luckily, for those who do not have a pension, annuities can help ensure that you don't outlive your principal; you'll have an even flow of money during retirement. Inflation, stagflation, deflation, high growth, low growth, etc. will not affect the amount that you draw.

If you have just retired at the beginning of a bull run you may be advised that you can 'safely' withdraw 6 - 9% of your portfolio on a regular basis. For a retiree starting with a Rs. 1 crore portfolio that means an income of Rs. 50,000 per month. That may have been a little optimistic. Mathematically speaking, for a portfolio of Rs.1 crore that earns 6.5% a year, withdrawals starting at Rs. 3.5 lakh per annum can be maintained for approximately 25 years before exhausting the entire portfolio. This sounds

good on paper but might scare the retiree – so scared that he may be paralyzed into not spending!

An employee with an assured future is willing to spend upwards of 90% of his take home income. For a retired person it falls to 15%; longevity and corpus exhaustion is a huge worry for many parents and their children.

Each retiree's situation is different. For a person whose children are well settled and earning quite a bit, fluctuation in the principal or income may not matter. For people supporting a challenged child or sibling a small change in income can be traumatic. Also, most Indians like to leave some money for their progeny. Such people also find it difficult if they have to exhaust their principal.

There are no studies in India showing how much can be safely withdrawn – so we will all have to live with our own experiments and conclusions. One assumption of longevity going wrong can make the whole calculation go awry.

- **Assets like RBI Bonds increase the success rate for low withdrawal rates, but most retirees would benefit with at least a portion of their portfolio allocation to equity.**
- **Retirees who want inflation - adjusted withdrawals must anticipate a substantially reduced withdrawal rate from the initial portfolio if they encounter a bear market!**
- **Equity-dominated portfolios using a low withdrawal rate may let you die rich, but live poor!**

Even if a portfolio can sustain a 5-6% withdrawal rate, retirees can benefit by giving themselves as much financial flexibility as possible.

A combination that a retiree can try is the following:

- Split his portfolio of Rs. 1 crore into 4 parts as follows:
  - ✓ **Rs. 50 lakh for an immediate annuity**
  - ✓ **Rs. 20 lakh in liquid/floater/arbitrage fund/company fixed deposits**

- ✓ **Rs. 15 lakh in balanced funds and monthly income plans (MIPs) of mutual fund houses**
- ✓ **Rs. 15 lakh in Equity Index funds**

Since the immediate annuity is a debt-oriented instrument, I am not suggesting any RBI bonds, senior citizen bonds, Jeevan Varishta Yojana etc. When the equity markets go up, you should sell some units from the index funds and put it into the floater funds. This asset allocation means the income from the annuity and interest/withdrawal from the floater fund will allow you to wait through a tough period of poor equity returns.

As you get older, you should withdraw systematically draw from the liquid/floater funds, and dip into the balanced funds and equity funds only during a bull run.

One important worry for retired people is "Will I exhaust my capital before my life-time?" or "Will I outlive my money?"

To stop worrying about whether you will outlive your money, here is a simple product called annuity.

An annuity is a contract with an insurance company. Usually, you pay premiums into a policy to accumulate savings/investment when you are in the accumulation stage (earning and saving for retirement) and then the insurance company pays you on a regular basis – like a pay cheque or a self - funded pension.

There are two key types of annuity: deferred and immediate.

Deferred annuities are savings annuities where you accumulate the money over a period of time, as a saving for retirement. Immediate annuities start paying you a stream of income as soon as you pay the lump sum and you can start it immediately.

What are annuities?
The textbook definition is that annuities are a complicated financial

instrument. Sometimes, they resemble PPF or other savings/investment accounts, and other times they resemble pensions.

Confused? Let us start at the beginning!

What is a deferred annuity?
A deferred annuity is what you'd use for savings or accumulating assets. **It's a tax - deferred account and functions like a PPF, except you can usually put in as much money as you want.** The penalties for withdrawal are very severe – the whole amount is added to your income! Sometimes the annuity could have an insurance component – ensuring a pension for your spouse even if you were not to pay your part of the contribution. Deferred annuities can be fixed (called the Traditional Plan) or a Variable Plan (also called ULPP – unit linked pension plan). In the former, you are guaranteed a 'final corpus' whereas in the latter the sum accumulated varies depending on the composition of the fund (debt or equity) and how well the fund got managed.

Have you bought it already?
Tax - deferred savings and investing is the best way to grow a corpus. For most people who were paying income taxes in the 90s there was the attraction of a separate deduction under the IT Act, 1961. This may have attracted them to buying a deferred annuity. The deduction available was quite small: only Rs. 10,000 per annum.

Today, there are many options for investors to save on a tax - sheltered basis without annuities.

You should consider a deferred annuity only after you have fully taken advantage of all tax benefits. The amount that is accumulating in this plan cannot be used for any other purpose, and a partial withdrawal is not possible. Also, annuities have an additional expense: mortality charges. Annuities have limited investment options, sometimes making it difficult to build a fully diversified portfolio. If you are maxing out your PPF and want to contribute to an annuity as well, make sure you choose one that has no

mortality charges and very low asset management charges (under 1.5% per annum) across all asset classes. Tapping an annuity before you hit the withdrawal age is never a good idea, though, because you'll owe a huge tax burden on the withdrawal.

Personally speaking, I am not a big fan of deferred annuity (classic plan): it offers a guarantee but also a very low rate and no flexibility at all on the premium payment. Instead buy a 'single premium deferred annuity' (in other words, deferred pension plan) where topping up is allowed indefinitely. If you are at least 15 years away from retirement you should not want your long - term money locked up in a government security-like instrument, although the asset management charges are lesser.

When are Immediate Annuities suitable?

An immediate annuity is a stream of income that an insurance company begins returning to you immediately from a lump sum paid by you. **You could look at it as a mirror image of the EMI that you pay for your home loan.** That money could have come from anywhere – say by withdrawal from your provident fund, withdrawal from your mutual fund, or maturity of an endowment policy. If it comes from a pension plan that you had bought earlier, then you are just shifting from the 'accumulation mode' to a 'withdrawal mode.' Having the insurance company start paying you out is called 'annuitization.'

So, this can be a very attractive option if you have a family history of longevity.

> **An annuity is attractive because the insurance company sends you cheques regularly for as long as you live. This is just like a pension – self funded. In other words, you can't outlive your money.**

Do you need it?

Setting aside a part of your accumulated corpus into an immediate annuity makes sense for most investors. Most people will have a retirement corpus lying in the public provident fund, company provident fund, mutual funds,

bank deposits, etc. Obviously, the most important priority is to create a new 'pay cheque' for your retired life and annuities are one good option. However, the interest rates are not very attractive and if you need to make a large, unexpected purchase, you will not be able to access this money. **Those who use an immediate annuity should put only a small portion (not more than say 30% of the corpus) into a plan like this.**

For most retirees, an annuity is a suitable product and almost a must if they do not have the basic skills of personal financial management. I believe they are not very popular only because annuities are complex financial instruments and usually sold inappropriately. When people buy annuities without complete knowledge, it invariably happens that the accumulation phase was done with a little on the amount to be accumulated at the end of the period. Since most of the buyers did not know what they were buying or why they were buying it, they did not seek any explanations on how it works.

An increasingly uncertain market may reduce the sale of variable annuity (unit linked) but conventional products should sell well.

Two phases of an annuity

The two phases in the life of an annuity are the accumulation phase and the withdrawal phase. During the accumulation phase, you can add funds to your annuity contract by paying a fixed amount on a regular basis as well as adding some money as and when your financial position permits. The advantage is that the amount accumulates free of tax and can accumulate in equity or debt options. You do not have to tell the annuity company how you wish to draw the amount on reaching vesting age. Once you reach the vesting age (which you choose and can be from age 45 to 80 years), you can get a fixed amount from the accumulation on a regular basis. This is called the withdrawal phase.

Annuity Payout Options

There are a few different methods for taking annuity payouts. Generally speaking, **the most common methods to receive cash payouts are the annuitization and systematic withdrawal.** Of course, you could also take

a portion of it as a lump sum on the day of vesting. The current law in India is that 1/3rd can be taken as a lump sum free of tax. The annuitization method gives you some guarantee of monthly income for a determined period.

Annuitization methods

Let's look at some different options you have with the annuitization method.

- **Life Option:** This provides the highest payout because the regular payment is calculated only on the life of the annuitant. This option provides an income stream for life, and acts as a hedge against you running out of money.
- **Life Option with return of Corpus:** The monthly payment is lower than that of the life option because the calculation is based only on the income generated by the corpus.
- **Period Certain with Life Guarantee:** With this option, the value of your annuity is paid out over a defined period of time of your choosing, such as 5, 10 or 15 years. Should you elect a 15-year period 'certain' and die within the first 10 years, the contract is guaranteed to pay your beneficiary for the remaining five years. If you live beyond the chosen term, you will get paid for your life
- **Joint Life Last survivor with or without return of Corpus:** Annuities payable to annuitant for life and after death to his/her spouse (if alive) for life. A variant is one that returns the corpus at the end of the term to a named beneficiary.

You can choose to get the payments on a monthly, quarterly, bi-annual or annual basis.

Lump sum payment

I do not recommend taking out the assets in your annuity in one lump sum because in the year you take the lump sum, income tax will be due on the entire investment - gain portion of your annuity. Clearly, this is a very inefficient payout option from a tax minimization perspective.

Insurance companies use many factors to compute your monthly payment amount– largely it is your life expectancy. Women receive lesser than men and obviously the older you are, the lower your life expectancy. A 75 - year - old man with the life option will receive a higher monthly payout than a 66 - year - old man because the older man's life expectancy is shorter.

If you opt for joint - life, again the pension will be lower.

Finally, the size of your monthly payout also depends on the insurance company that you use, and its expected investment returns on your money. If the company can make a 7% instead of a 6% return with your money, your payment will be higher.

Tax treatment of annuity payouts

Unfortunately, annuity payments are taxed at full rates. So, the annuitized amount is just added to your total income and taxed.

Conclusion

Deciding on the best annuitization payout method to choose for your annuity is not an easy decision. Consider your priorities, the amount you need each month and how long you think you will need these payments.

A final factor to consider is the credit quality of the insurance company. **Remember that just because you have accumulated your annuity at one insurance company, you need not take the annuity from them.** India does not have a credit rating agency that rates life insurance companies. This is a major limitation. Obviously, the biggest annuity provider in the country is LIC. However, before you decide to change the annuity provider (or choose a new one), you might have to look at whether there is any surrender charge and what are the total asset management charges.

Whenever we talk of retirement, the word that comes to mind is the cliched word 'nest egg'. **Nest egg** is the entire retirement basket that you have created to look after your financial requirements during your retirement years. Retirement planning includes one very important phase - more than

just sitting on and growing invested capital. The ultimate purpose of the nest egg is to be hatched!

India is a young country and therefore most current literature is focused on the accumulation phase of retirement planning. This is the first step. The trend toward individuals having to assume responsibility for a significant portion of their retirement income is of recent origin.

The second step is to know how to use the money! Knowing when and how much to withdraw and how to re - balance are important. The difference between Phase 1 (called the accumulation phase) and Phase 2 (called the withdrawal phase) is so huge, that it is like 'putting the man on the moon' and 'bringing back the man from the moon'. If you do not know how to do Phase 2, all the efforts in creating the 'nest egg' in Phase 1 will be laid to waste. The second phase is far more critical! There are many new challenges associated with investing for income and growth rather than just growth alone. Investing (accumulation phase) and spending (withdrawal phase) are obviously opposite to each other, so some of the steps are different.

Over the years, you have been bombarded with philosophies of 'SIP', 'averaging', etc. This involves keeping the rupee amount constant – and buying more units when the market is down and lesser units when the market is up. All you have to do is purchase a consistent rupee amount of units on a regular basis. Say for example, a unit is selling at Rs. 50 one month and you buy 400 units. But then, if it drops to Rs. 40, and you bought 500 units, then you wisely purchased more units at the lower price. You just decided to invest Rs. 20,000 each month — through an SIP. Over time, this approach allows you to 'systematically' purchase more units at lower prices than at higher prices. It takes the emotion out of investing – and it helps.

Now, consider the tale from the other side. That is, if we were dealing in a close - ended fund (i.e. the total number of units is fixed). If you are buying low and selling high, is there some other person who is forced to sell low? You bet, yes! He is the retired person who is living off his equity fund and

therefore doing a Systematic Withdrawal Plan (SWP) to meet his day-to-day needs!

Equity markets always go through a cycle – so the same market that helps the 'SIP' actually hurts the person doing the 'SWP' - it makes you sell more when the market is low and sell less when the market is high! Mathematically, this is fairly obvious. Is it possible during retirement for us to create a natural way by which we sell high in withdrawal phase as a natural tendency to buy low in the accumulation phase? Yes, of course.

An extended bear market especially during the early years of retirement can be worrisome (financially and psychologically), if one has to sell a big portion of units at low prices to meet income needs. And, if you have just come out of a bull market, your last few purchases (when your earned income was at its peak) would have been at high prices. A classic case of **buying high and selling low** – an investor's nightmare! **It is risky, unnecessary and almost foolish to have everything tied up in equity during retirement, even though it can be tempting in a bull run, especially if this strategy worked well prior to retirement!** Still, equity usually does outperform other types of investments over the long-term.

So, let us come to the million dollar question. How much money should a retiree have in equities and how much in other asset classes?

When you decide how much to invest in fixed-rate investments, what you are really deciding is how long you could wait if necessary before selling equities. This gives you time in a down market to just watch the market and not be forced to conduct any transaction.

You are giving yourself some time and breathing room in case your equities enter a bear market. This way you can still meet your income needs from the fixed-rate investments without having to sell your equities in a bad market. The more your 'other' income, the longer you will be able to wait.

Your waiting time is decided by the following 4 factors:

- **The size of your monthly pension**

- **Your interest income**
- **The dividend income from your equity and equity mutual fund investments**
- **Your expenses**

So, when you do asset allocation you should be planning for 'equity sales waiting periods' rather than a mathematical thumb rule of 30% in equity and 70% in debt for a 70 year old! Like all thumb rules, it may not work on the other fingers.

The key to this is to purchase fixed-interest bearing investments with staggered maturities so that as they mature, the matured amount meets your income needs and you are not in a distress sale situation. **The gist is that you divide your portfolio into two or three buckets. One piece is used to buy fixed-income investments that provide regular income. The second portion is some money to be kept in a fund with a large amount of debt and some small portion in equity. The third bucket is your 'volatile assets' – which could be units of a mutual fund investing in equities and real estate.**

If your units do well, great! Let us say you target to get 16% returns in equities. You could create rules like the following:

- ✓ Equity portfolio goes up by 0-20%: No action
- ✓ Equity portfolio goes up by 20-30%: Sell 10% of equity portfolio
- ✓ Equity portfolio goes up by 30-40%: Sell 10%
- ✓ Equity portfolio goes up by 50%: Sell another 10%.

Use this money to buy some debt instruments, in a liquid fund, if you think you will buy some of the equity when the market goes down or to create an annuity.

This ensures that every time the market is high, you sell equity shares, and use that money to buy 'time' which helps you to stay away from needing to sell equities during bad times. Of course, you should not go overboard. When you are 65 you have provided for 30 years of your life,

you now need not even worry about re - allocating. For you, allocating, re - allocating, etc. are just theoretical! Eventually, all equity will have to be sold to purchase additional fixed - rate investments for creating an income flow. This approach is superior to a brainless SWP.

Your income will be guaranteed for a predetermined number of years before having to sell units – I recommend at least 5 years. If you are more conservative, make it 10 years! Your equity portfolio will be still around to participate in the next boom. You will be in complete control of your plan rather than letting the markets be in control of you. You will exit equities when you want to and not when you must. Your portfolio will allow you to sleep well knowing that you have your next 7 years expenses in fixed income securities!

Retirement planning includes much more than just investing capital for growth. The ultimate goal is steady, dependable and lasting income. It is also creating a bigger corpus if you wish to leave it to your next of kin. With careful planning that includes long equity holding periods, we can balance the needs of inflation protected income and long-term growth during retirement. After all, there is no 'good' egg or a 'bad' egg. An egg has to hatch, and the bird strong enough to fly!

You may also decide to end this game of allocation and re-allocation on reaching a pre-determined age and put all your money in old-fashioned bank fixed deposits. At this stage, you do not wish to do anything except withdraw and spend! **Total and complete simplicity in a portfolio is a luxury for most people.**

CHAPTER 19

Borrowings 101 – A Tale of Credit Card Anomaly

CHAPTER

Borrowings 101 – A Tale of Credit Card Anomaly 19

Food for thought:
• How wrong can one go with debt?

A story on credit card debts:

'My Grandson has run up a HUGE debt! Fool as he is, I am going to repay it in one shot,', said a friend's father.

'DO NOT REPAY the loan,' I told him.

He was really shocked – being aware of my anti-debt stance and hatred towards paying interest.

I asked him for the amount of debt. The debt was Rs. 95,000. Not too big, since the grandfather had a net-worth in excess of Rs. 20 crores, so paying this off in a jiffy would not even be felt by the family.

'He that goes a borrowing goes a sorrowing.'
- Benjamin Franklin

I told him, if your grandson has incurred this debt, it is a SYMPTOM of him living beyond his means. It is not THE PROBLEM. The problem was elsewhere.

So I called the boy and the conversation went like this:

Me: Tell me how you ran up this debt of Rs. 95,000, and how you plan on repaying it.

Him: I can repay Rs. 4,000 a month, so over 25 months I will be able to repay the debt.

Me: How did this build up, but?

Him: I went to a disco with a couple of friends – it cost me about Rs. 13,000. Bought a mobile for Rs. 18,000, and went for a friend's wedding – that was Rs. 11,000. Other than this, it was other expenses on eating out, buying some clothes and CDs…and everything kept adding up.

Me: In 9 months of working you have earned Rs. 24,000 a month, and OVER SPENT Rs. 95,000 – is this not bad?

Him: Yes, I feel terrible. My take home pay is about Rs. 19,000, I pay rent of Rs. 6,000, and after paying for food…I have ZERO balance.

Me: How will you repay, then?

He had no answer.

I gave the following solution.

The boy would keep the credit card in the grandfather's possession. He would change the address of the card to the grandfather's address, and he would get himself a new card with a limit of Rs. 25,000!

The boy would pay x Rs. per month, and the grandfather would also pay Rs. x – match the grandson rupee for rupee.

I also said…up to Rs. 4,000 a month, grandfather would match 100%, and beyond Rs. 4000, he would match 125%. Hence it became a clear incentive to reduce the standard of living and repay FAST.

But there was a catch. Grandfather had to be repaid at the same rate at which he gave the money – and he had to start a SIP of Rs. 2,000 per

month.

The kid paid up fast, the Grandfather was happy with the solution (thrilled should I say) and hey – I got a story to tell!

I explained the concept of a ‘moral hazard’ to the grandfather. If he had paid off the whole debt, he would have run up a debt again.

CHAPTER 20

Retirement Blunders to Avoid

CHAPTER

Retirement Blunders to Avoid 20

Food for thought:
- What are the most common mistakes?
- Some questions you might need to tackle

Retirement is the most important goal for many of us. Yet, looking at the numbers, it is clear that many investors are undermining their good intentions with unfortunate actions. Or inactions, should I say? All their good intentions mean nothing if there is no action. Here are ten mistakes to avoid if you want your retirement dreams to become a reality.

"Be not ashamed of mistakes and thus make them crimes"
- Confucius

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1. **Consuming your retirement corpus much before retirement:** A study by OASIS found that most employees cash in their provident fund when they switch jobs. Most of them withdraw the money for various reasons such as marriage, festivals, consumption, etc. In other words, they take the money, rather than leave it in a retirement account. That's no way to build the retirement of your dreams. If the amount in your provident fund at retirement is Rs. 24,000 (as per the Oasis report), I seriously wonder how long you wish to be in retirement.

When you change jobs, you can transfer the money in your employer provident fund to a government run scheme that will allow the money to continue growing tax - deferred. You might also be able to leave the money in your old plan or transfer it to the plan at your new job, depending on the plan's rules. If you are self - employed, there are mutual funds and life insurance companies, which have nice schemes in which to accumulate this amount.

2. **Postponing/Procrastination:** Cashing in your provident fund at a young age is not the only way for your retirement fund to meet an early demise. Not saving enough in the first place will guarantee that your retirement will be painful. Of course, no one wants to be told to 'save' -- it is so boring and perhaps not gratifying at all. It is all about choices – if you choose pain now, pleasure will come later on. If you choose pleasure now, pain will follow!

   This is what low - savers (and non - savers) are really doing: they are spending their retirement now, which may mean they will not be able to retire at all. Buy that Plasma TV now, or buy time in retirement tomorrow. Take a cruise this year, or take time off several years from now. Those are the choices you have to make. Building a nest egg is not a decision of whether to consume, but when to consume. Do it now and you will not be able to do it later without having to work for a salary. Translate all your needs into 'number of day's effort' and you will realize the real cost. If that dream house is Rs. 72,53,000, and your take home pay is Rs. 8,00,000, it means 9 years of your life is for your shelter on a gross basis. On a net basis (i.e. the savings per year, it is perhaps 18 years effort). How to arrive at the cost of the house? Just multiply your EMIs with the number of installments. You might surprise yourself in how expensive your house is!

3. **Having no clue about how much to save/ invest.** According to a survey by a newspaper, many employees have not calculated how much they need to retire. However, you cannot get to where you want to go if you do not know how to get there.

4. **Spending your retirement savings too fast.** If you have made it to retirement, congratulations! You have done the first part. Now check how much you have. Nevertheless, you cannot take it too easy. Because you will receive a severe pay cut if you deplete your portfolio too fast. How much can you take out each year and be almost certain that you will not outlive your savings? Just 6% a year. That is the withdrawal rate that would have sustained a mix of shares and bonds over most 30 - year historical periods. Sure, if you retire on the eve of the next bull market, you can take out more. However, if you quit working right before the next bear market, then taking out more than 6% a year could have your portfolio beating you to the grave. The corpus has to feed you, clothe you, cure you, protect you and keep you in your shelter while keeping pace with inflation.

5. **Asset allocation! What is that?** Almost all the people I meet let too much money lie in their savings bank account. Too many young people keep too much money in debt instruments like national savings certificates, public provident fund, endowment policies, etc. Nothing can kill a retirement like bad investment decisions, whether it's owning too much of one share, letting emotions take over, chasing the latest fad or letting short - term events affect your long - term strategy. This includes being too lazy to move money from a savings account to an investment account.

6. **Letting the taxman into your investment.** There are many types of investments and investment accounts, and they all have their own quirks when it comes to taxes. Not knowing all the rules can lead to too much taxation and less money for retirement.

   Profits from shares or mutual funds that are held for at least a year will be taxed as long-term capital gains — a rate currently nil. Interest from bank deposits, on the other hand, is taxed as ordinary income — a rate as high as 35%. Yet, investors keep their money in bank fixed deposits, RBI bonds, NSC, etc. Asset location can be just as important as asset allocation. Even if you wish to have liquidity for some portion of your money, you are better off in an income fund, FMP, or a floater fund

rather than a bank FD or RBI bond – completely from a tax point of view.

You basically have two choices: You can be a master share-picker and try to find the next Wipro, or decide whether a dividend yield makes a company a good share. Or you can broadly diversify your assets, mostly via low - cost index fund. Or look for good mutual funds or unit - linked policies. This way, you enjoy exposure to blue chips — and smaller growth firms.

7. **Not looking after your health – physical and financial!**
   Every time you eat out check if you are putting enough money into your retirement investment accounts. If you eat out today, you will eat out 30 years hence, and ensure that you have enough money to do that. Every time you eat, promise to take it off the next day at the gym. Remember, as you get older, you will eat out, go to the gym, go to the doctor, etc.

8. **Paying too much for help. There is nothing wrong with getting financial advice.** But have you wondered who was paying the bills for your adviser's, fund manager's or banker's foreign junkets? Remember, it is you. Many mutual funds, insurance plans, PMS schemes and other collective investment schemes have not reduced their fees despite their assets growing at a fantastic pace. Paying too much for advice does a lot for your broker's retirement, not yours. Paying just 1%, a year on a Rs.10 lakh portfolio over 20 years could result in your forking over more than a million rupees in fees. That's a million rupees that could have been in your retirement plan. Of course, if the advice you received had your portfolio performing better than what you could do on your own, then the price might be worth it. But, if you are paying 2% or 3%, a year to lose to an index fund — as most mutual fund managers did last year — then you're better off taking control of your own investments. Or shifting to a simple, low-cost, low-tracking error index fund.

9. **Retiring when you needed a break.** If you are in your 50s, you should plan to live at least another three decades. Can you stand full-time leisure for 30 years? Sure, it may sound good now, but many retirees find they get pretty bored after a while. Look around in your family to see how long you will live. If your dad, mom, uncles, aunts, are all traveling around in their 80s, and living in their 90s, so will you! Before you decide to retire fully and permanently, discuss a phased or gradual retirement with your employer and/or business partners.

10. **Hoping that your kids will take care of you:** Not that they will not. Maybe they cannot. Do you expect your recently bereaved 64 - year - old son to take care of you? What about your daughter who wants to spend 4 months with her daughter in the USA ? It is a physical impossibility for many Indians who now lie scattered around the world. A day care centre is a reality. So go and provide for day care too!

Some queries I often get on my blog:

1) **Do you think pension policies from insurance companies make up for a good investment for availing pension? Why or why not?**
Answer: No. They do not. First of all, thanks to some Quixotic regulations, no life insurance company is selling a pension plan, and hence this question is irrelevant.
I do not prefer a 'made by insurance company' pension plan, because in a typical traditional plan, they do not tell you what are the costs, where they will invest, who is the fund manager – you are playing blind. The chances of accumulating an inflation adjusted surplus is almost close to zero. Not worth putting your hard-earned money into it.

2) **In case of pension policies, should one opt for traditional or ULIP? Does it depend on the age bracket one is in? Please explain?**
Answer: If you must opt for a pension plan by a life insurance company opt for a unit linked plan with the following characteristics: low up-front charges, asset management charges less than 1.25% to

1.5%, a high level of equity (if you have 10+ years to go, get to 100% equity if it is possible). Do not touch the traditional plan at all.

3) **While choosing an investment option for retirement corpus or pension for retired life thereafter, what factors should one consider?**
Answer: Simplicity – considering that you may be using this instrument in your 80s and 90s.
Some other factors you should keep in mind: Ease to operate, physical support near your place of stay, automatic debit/credit to your bank account, friendly people operating it, tax efficiency, and the ability for your spouse or children to manage it if you are incapacitated.

4) **Is money accumulated through EPF or PPF enough for retirement? Or one should have a number of products to meet this goal? If yes, what should be their allocation in the portfolio?**
No. Money accumulated through EPF OR PPF will not be sufficient for your old age or retirement. If you have a good EPF scheme and you are investing in PPF for a long time, you need a well-managed Equity Fund.

CHAPTER 21

Impediments to Riches

CHAPTER

Impediments to Riches 21

Food for thought:
• What is stopping you from getting rich?

Here are my observations as to why people do not get rich. Almost all of them will justify their not being well off – "I had to pay for my parents' expenses,", "My children's schooling is expensive,", "My medical bills aren't coming down anytime soon,". These are but rationalisations, and the deeper answer lies in some very ordinary sins we daily gleefully indulge in.

'The only way you will ever permanently take control of your financial life is to dig deep and fix the root problem.'
- Suze Orman

First on the list, the activity people learn since childhood but go wrong with all their life:

Spending.
We spend most of our money using electronic gadgets – online, credit cards, debit cards, etc. This has one convenience of course – of not having to carry cash. The other advantage is that the data on what you spend is electronically available and can be analysed. Here is an attempt – this of course is generic, but you can analyse your expenses too. Let me enumerate them:

You bought a house too big or in too expensive a location: Did you stop to think whether you could have bought a flat in a slightly less expensive location, or just a smaller house? Do you realize that your Housing EMI is forcing you to work longer and compromise on the size of your Retirement corpus?

You have replaced your car too soon: Most people buy a car every 5-6 years. Really? Is it necessary? Can you not push it to, say, the 8th or 9th year? Or buy a smaller car? A bigger car costs more in not only fuel, but also insurance, maintenance, etc. See if you can work with a smaller car – given Indian roads you really cannot unleash the power of a bigger car anyway.

Your trading mistakes: The 'small trading losses of Rs. 2000 or Rs. 200,000', depending on your portfolio, all add up. Losing money while trading is a big drain on your ability to save money.

Appetizers / Salads / Desserts: Eating out is not a very sensible thing to do, but we all do it. The big worry here is not the food bill, but the subtle manner of increasing your bill. As soon as you walk in 'Water – bottled or ordinary', then the offer of appetizers, papad, salad, and in the end, the dessert. Be careful of how you are being had. Monitor your eating-out expenses, and find substitutes like packaged sweets (even better, make them) and consume at home – at least you are not paying for the ambience!

Clothes: It is not just which brand you buy, but also how many such clothes you buy. Do an audit of your cupboard. Cross your heart and ask yourself if that you need those 122 shirts or 54 pants! This may be an exaggeration but according to a retail trade expert, the shops in Mumbai have more stock than what Mumbai buys over a 5-year period. Now do an audit of your house – do you have more clothes than what you can wear over the next 5 years? We buy too much, store too much, but do not use them.

Coffee! it is no longer Rs. 15 or 25 in an Udipi restaurant – it is Rs. 160 in Starbucks or Cafe Coffee Day. And all these amounts add up. Imagine Rs. 150 twice a week – this is about Rs. 1200 a month. Imagine what Rs. 1200

SIP in a good equity fund can do for your portfolio over the next 40 years. That is the title of this book!

Gadgets: How can we forget this? The gadgets without which we cannot live are costing us our retirement. How much you spend on a phone for yourself and your family is of course your business, but do you realize the 39-year impact of Rs. 28000 paid extra for a 'must have new toy'?

Vacations: Of course, you deserve your vacations, but after you have ensured a worry-free retirement. I've got no problem with one really cool trip each year, but the problem is how families have now raised their expectations so each new trip has to be better than the last one. Not every vacation can be Ritz Carlton in the Cayman Islands or Kempinski Grand in Switzerland.

Procrastination learning about money: Most of us love money, but are not willing to learn how to earn well, invest well, etc. The more you postpone, the lesser the chances of accumulating a decent corpus for any goal.

Procrastination of financial learning also means not knowing the cost of postponing investments. Thus, we keep postponing to a virtuous tomorrow and do not save, invest, or organize our finances today. Tomorrow, as we know, never comes.

Going into debt without a thought: Many individuals will just walk into a shop and buy a Rs. 55,000 item without worrying where the money is going to come from. So it is a want that is charged to the credit card – not just the needs. Then the credit card company offers an usurious rate for an EMI which they have to accept. So if your luxuries are funded at 43% p.a. interest costs, you cannot get rich. Just perish the thought.

Not saving / investing in an organised manner: Need I say more?

Not knowing what is investing: An occasional equity share bought when the market goes down, averaging a falling share, investing in

some sundry mutual fund, then selling because you have held it for 4 years – a series of disjointed, strange, and irrational actions is not investing. It is called passing time. When they show me that portfolio I know what they are doing, but believe me IRR is like a taboo word for them.

Being too aggressive: Buying a couple of low-tier cap and fooling themselves into believing that they are in 'mid cap' direct investing.

Being too conservative: Some people could tell you a million stories of how their friends lost money in the equity market. I tell them stories of plane crashes and road accidents. Why, even tiger mauling, dog bites – after all, risk has to be managed, not ignored.

Giving 'loans' to friends, relatives, neighbours: Some people never learn to say the magic word 'No'. And then there are some others who give loans to show off how rich they are. Neither the friends nor the loans come back.

Bad financial habits: drinking, gambling, playing on the stock market – there is no dearth of these activities which can completely wipe out your wealth.

CHAPTER 22

Peer pressure and tackling it

CHAPTER

Peer pressure and tackling it 22

Food for thought:
• The art of pressurizing without speaking
• How to tackle it

My work is very interesting. It involves a lot of reading, travelling, listening, and talking.

I see a lot of millennials. Actually, I see a lot of young people from their 20s, right up to their 50s and I see them embroiled in financial 'peer pressure'.

'If you follow the crowd, you might get lost in it.'
- Unknown

Have you ever wondered how some people your age can afford designer clothes, eating out three times a week in fancy hotels? And those yearly phone upgrades?

While your friends do all that you might feel miserable paying your SIPs, watching the markets go nowhere and asking yourself 'is it worth listening to Subra and doing that @#$%%% SIP which is giving me … some return?'

Fair enough. It is always a question of what I see vs what you see.

You see a nice clinic and a young super specialist doctor.

I see a multiple education loans, a rich parent, and a lot of hard work.

Behind the Fairytale :
When a person wants to be a doctor, it involves a lot of hard work; 5 years of education post class 12th, specialisation, and then super specialization. It is not an easy degree to get, and if you have to study in a private school like Manipal, the education costs can rip you apart. Either I see a rich parent supporting this with his own money, or a student who has a huge loan burden which he is going to repay over a 10 to 12 years long period. Nothing less.

You see a nice, beautiful house with a lot of interior work.

I see a lot of debt, term insurance, lousy jobs, and almost a financial prison – with a self-imposed cycle.

Through the looking-Glass :
A nice house, if bought with the earning and repaying capacity of a 30-year-old couple, has to be far away from town. 'Drive till you can afford' is a very Mumbai centric dialog – and is universally true. So if 2 friends earning about Rs. 13 lakhs each have committed to Rs. 87 lakhs of home loan, 12 lakhs of car loan, have some educational and personal loans – frankly I can see tensions, delayed EMI payments, etc. Or one of their parents will bail them out.

You see a Rs. 1.5 million bike or a Rs. 3 crore car.

I see a lot of debt, a bottomless pit, a huge lifestyle addict and lots of energy bills!

On the other side :
All the higher end vehicles have an amazing head turning ability. However, finance people like me keep wondering – do they have a kitty for the rainy day? Do they have medical insurance? Is it safe riding the Rs. 1.5 million

bike during the monsoon on the Expressway? These toys are nice to own, but only with your OWN MONEY.

You see a destination wedding.

I see a father playing to the gallery and wondering why he went berserk trying to please his spouse and kid!

Reality Check

Expensive, real expensive Indian weddings are held in various destinations – I saw a wedding hall with a Rs. 1 crore per day rent which did not include the food costs. The food costs varied from Rs. 1000 for breakfast and about Rs. 5000 per plate dinner. Sure, if you have earned the money and can afford it, do it. By all means. Sadly, rich people play a role model for the society in which we live. So many a times I see the parent actually take on a lot of debt to 'show off'. It takes its toll.

I can go on and on, but we digress from the point.

When you are young, peer pressure is difficult to handle. However, even when you grow older peer pressure seems to be difficult to handle. If you have created an image for yourself (which is not true, and another psychological can of worms) and you keep trying to live up to that image, you really struggle. How does one really handle peer pressure?

Let me share a few ideas – see what works for you:

1. Living up to the Joneses is a real trap: If you are NOT self-confident, you try to compete with everybody around you. So suddenly your driver, yoga teacher, gym instructor, boss, wife, children – all of them start giving you a complex! So building up real self-confidence is a very important step.
2. Others do not really care: Ask your friend whether he remembers what dress he wore a week ago – chances are he won't. If he does not

remember what dress he wore, why the hell will he remember what you wore? As long as your clothes do not stink (wash them regularly please), are not falling apart (clothes do not tear these days, right?), and are not too out of place (wearing shorts to a temple or a dhoti to the beach) – chances are that nobody gives a second glance to what you do.

3. Your phone should receive calls and send SMS messages. Along with that if you can check your email that would be great. So a simple smart phone is enough. Tell your friends that you want to see whether you are able to use a phone for 5 years. Tell them (and maybe start one on FB?) about the '5-year challenge' – and see who wins it.
4. Tell people you have a goal and you are saving / investing for it. Tell them you are planning to start a business and are saving for that.
5. Do a real big SIP in a mutual fund – and tell them that you are paying off a big loan. This could be
   a) an educational loan
   b) a personal loan taken for a family medical need
   c) a loan to repay some business gone wrong
   d) a gambling loan or a parent or a sibling

   Make a nice story. You get sympathy, and a solid reason to be broke for about 5 years. Then change jobs or geography.
6. Tell your friends that in your community a girl will not marry you unless you have a house in Mumbai. That will keep you broke for the next 70 years! (Of course, no worries as long as you do not REALLY BUY a house)
7. Tell them your company is doing very badly, and you are terribly, terribly over paid. This means if you lose your job you will take a long time to find a new one, or you will find one that pays too badly, so you need some financial cushion.
8. Change your friends' profile: If you are in a group that is from an economically much higher class than yours, YOU are the problem. You are in a wrong group. Change your friends. It is nice to be ambitious, but foolish to try to live up to the expectations of friends who are much richer or earning much more than you.

9. Just say NO. I do not think it is easy for young people, but it is working for a few of the kids I have met in my travels.
10. Tell people you are saving for marriage – and all the expenses have to be borne by you. This one gets sympathy like no other.

SEE WHAT WORKS FOR YOU!

CHAPTER 23

Avoiding Ponzi Schemes

CHAPTER

Avoiding Ponzi Schemes 23

Food for thought:
• What are Ponzi Schemes?

I have always held that to accumulate decent money, keeping away from danger is very, very important. We regularly find investors losing big sums to some glib talker. Big has to be contextual of course – a maid servant losing Rs. 84,000 is as bad as a senior executive losing Rs. 8,50,000 or a businessman losing Rs. 55,00,000!

'We do not live in an economy,
we live in a Ponzi scheme.'
- Douglas Rushkoff

The SEC in the USA regularly publishes stories about ponzi schemes where people are collectively defrauded of amounts ranging from a few million to 2-3 billion. The term comes from Charles Ponzi, who in '20s stole from fellow Italian immigrants. But his swindle earned peanuts compared to some of the current day fraudsters. From Shapiro's alleged scam to Allen Stanford's $7 billion to Bernie's Madoff's all-time $65 billion topper, Ponzis come in many shapes, currencies and sizes now.

In the Indian context I know of retirees who lost money in chit fund schemes in West Bengal and those who lost money in Jignesh Shah's commodity funding schemes.

More frauds will come to light as bull markets mature, interest rates in banks fall, and desperate and greedy investors seek higher returns. These frauds remain undetected in a bull market and come out only when the market crashes – or at least enters a bear phase. Ponziers pay phony "returns" to their earlier investors! Obviously, the funding for this comes from the newer 'prey' aka investors who are happy to take some money off the market.

The scammer can't provide promised payments to the many from fewer new investors. It is exactly then that the cracks appear. Some of the luckier ones are able to bail out. However, when some of them bail out and no new money is coming in, the IMPLOSION of the scheme happens. In India the regulators wake up ONLY when the scam reaches the Rs. 50,000 crore benchmarks. At the earlier stages the regulator is normally sleeping at the wheel.

How do you protect yourself and your Retirement corpus from such fraudsters?

Protecting yourself means knowing and learning the signs that an "investment" is actually a Ponzi scheme.
The con artist takes "custody" of your money. The claimed past returns are unrealistically high and consistent, maybe between 18-22% every single year. The con artist's "strategy" is complicated and jargon-packed, using endless terms normal people cannot understand. They get a low-end bank employee or a temple trust employee and rope him/her as an early client. Then they give the assured return to that person for a few months.

At this stage they pressurize him through the 'Do you not want your friends and relatives to have the good fortune that you have had' tale. So this man either becomes an agent with a commission, or just a free goodwill ambassador in that community. A banker or a temple employee can get a lot of referrals! Bernie Madoff used this scheme extremely well.

Jargon

Investments should always be explained in a simple way so that you can understand (do I need to say it has to be elucidated well enough so that you can fathom it?). Showing off one's language or communication skills is a scary thing. One of the famous Khans of the film industry met 2 representatives trying to sell an endowment plan. After listening to them for some time he said "I cannot understand this product, SO I DO NOT WANT IT". I do not wish to elaborate more, but if he can do it, so can you. Do not invest in products that you cannot understand.

Most people I know would have done much better if they had kept their money in an index fund instead of looking for schemes like Madoff's.

> **Excellent years only! Most of these conmen show you 18% consistent years. They try to tell you it is like PPF – except that it has a better return. So what can be better? An assured 8% pa or an assured 18% pa? Please remember that there cannot be any instrument that can give 2x the inflation and have a standard deviation of 1. To get higher returns you need to take higher volatility along! In 2017 mid-caps gave 79% return in one fund. I can assure you that this will not be repeated anytime soon. It will catch up with the mean.**

References

I know of some professors of a college who have recently been attracted to a 'Wealth' management firm which has slowly started skimming them. Aggressively asking for references works well with people with limited understanding. Professors of math, stats, chemistry can easily be asked to do a 'SIP' in 'ULIP' – after all so much is being said about 'MF sahi hai' and 'SIP cannot lose money for you'.

Do not be carried away by references by people who do not understand investments. Of course, if their title is 'Head of finance – A big group' be more careful!!

Investing is a great profession but a very expensive hobby. It is also very complicated on one level and very simple on another. You have to know how much time, willingness and effort you wish to put into the investing process. Financial planning is not just about investing. It is also about goal setting, accounting, monitoring the investments, etc.

If you are NOT willing to invest your time in learning about investing, you are better off investing in an index fund.

Make your choice!

CHAPTER 24

Investment Primer

CHAPTER

Investment Primer 24

- Some aphostles for first-time corpus builders

To retire you need to create a corpus. To create a corpus you need to be a good investor. Let's tackle this separately by first looking at some of the characteristics of a good investor. Then, we will look at learning about investing.

"Risk comes from not knowing what you are doing"
Warren Buffet

First, become an investor. If you have not already made the jump from being a saver to being an investor, start now. The difference is in the mind set; as a saver, you have seen your money grow on a regular basis. The situation is drastically different when you are an investor — you may see no growth, de - growth or mad, fast-paced growth – this can be unnerving if you have been a saver for long! You need to re - orient your own view! **Over long periods, equities give good returns and help you create wealth.** If you are looking at a comfortable retirement, you need to invest in equities – start aggressively when you are young and rebalance when you touch 50 years of age. You will continue to hold equity even in retirement – thanks to longevity – so, an equity - oriented portfolio is more necessary for you compared to your parents. If you do not understand equities and mutual funds do not panic. Choose some good mutual funds, index funds, and exchange traded funds. Use index funds and large-cap funds as the 'Core'

of your portfolio – 75% of the amount allocated to equities. In your balance (i.e. 25% of the amount allocated for equities) you can choose some mid-caps, specialty funds, etc. Taxes are a big drain on your portfolio – so, even if your portfolio comprises mostly debt or equities, it makes sense to stay in the market for a long time and ensure tax breaks.

Some characteristics of a good investor:

- ✓ They choose a financially smart life style – they spend less than what they earn! This means only smart debt and a frugal life style – clearly keeping early 'Financial freedom' as a very important goal in life.
- ✓ They keep records of their spending and investing. Most of them monitor their net worth and not their month - to - month salary.
- ✓ They establish an emergency fund – so that they do not have to dip into equity funds when the markets are down.
- ✓ They start early, invest regularly and keep the long - term view while investing. Keeping time on their side is a very, very important 'smart investor' characteristic.
- ✓ They invest in education – including investment education! Knowing how you are investing is very important for your well-being.
- ✓ They understand that it takes a complicated mind to do a simple thing – for most amateurs, indexing is far better than chasing fund performance.
- ✓ They understand the costs of investing and so make a choice with a strict eye on costs.
- ✓ They understand risks – and learn to manage risks.
- ✓ They do sensible asset allocation between assets they understand – normally equities, real estate, debt and commodities.
- ✓ They have an Investment Philosophy Statement – clearly, they do Goal-Based Investing. Goals are written down and tracked.
- ✓ They understand the advantages of deferring tax to the date of withdrawing rather than paying on a yearly basis.
- ✓ They invest, and do not trade or speculate. Most of them understand trading is not investing! They avoid performance chasing, market timing and other gimmicks like the plague!

- ✓ They are masters of their emotions: as Peter Lynch says, "Investing is about having a strong stomach – and a reasonable IQ"

Now that we have seen some of the characteristics of a smart investor, welcome to the world of investing. As an investor, you will have many questions – right from the difference between saving and investing, why invest, is investing different from speculation, what is risk, and so on.

If you watch television, you may have been bombarded with words such as fundamental analysis, technical analysis, growth option, dividend option, equity funds etc.

If you are a novice and need some basic explanation on investing, you have come to the right chapter.

Risk and Return: When we talk of risk, there are various types of risk. In case there is a possibility of making a profit or loss, it is called **speculative risk or investment risk.**

When the only outcome is either a loss or not a loss, that risk is called a **'pure risk' or an insurable risk.** Death, critical illness, illness, accidents – all these are pure risk and thus insurable.

Investment risk is the risk of variability of returns. Sophisticated investors see risk as a variability of return – normally retail investors view risk as an erosion of capital.

Let us try to understand the risk of the following instruments:

- You have invested in RBI bonds at 8% interest for a period of 5 years. At the end of the period, you get the 8 % interest and the principal back on the due date.
- You have invested in Sachin Technologies Ltd. this year worth Rs. 50,000.
- This company's shares were worth Rs. 60,000, Rs. 100,000, Rs. 175,000, Rs. 50,000 and Rs. 67,000 in the 5 years that you have held the shares.

Which of these had a higher risk?
For most investors it will look like Sachin Technologies is a risky investment. Correct?

Why?
Most of us confuse volatility and risk. In terms of returns, both RBI bonds and Sachin Technologies have given **the same return** when held to maturity! However, your stomach must have gone through a lot of turmoil in the 5 years that you held these shares – whereas the RBI bonds gave you a peaceful night's sleep. So, when we talk of risk, one way we can ask that question is "For getting these returns how many sleepless nights did you spend in the 5 years?" – the answer to this question shows your ability to handle volatility. How strong are you to bear the turmoil? Only you can answer this question.

It is also necessary to appreciate that instrument risk should be considered only after considering the company risk. What it means is that the **'secured non convertible debentures'** of CRB Capital may be much more risky than the equity shares of Tata Steel. Thus, company risk, including quality of management, size of balance sheet, stability of earnings, etc. is more important to consider from a risk perspective. **Annual yield (Rate of return) = annual income + [end price – begin price] / begin price**

For e.g.: You bought 1000 shares in Sachin Forgings Ltd. at Rs. 40 per share. The company paid Rs. 4 as dividend and the share is worth Rs. 41 at the end of one year. What is the rate of return?

Return = 4 + [41 – 40] / 40 * 100 = 5/40 * 100 = 12.5%.

What is yield?

What is the return that you get for investing in any instrument? Call it interest, capital gain, dividend or rent; it means what is our 'cash flow' for laying out a certain amount of capital. The return you get on investments is called 'yield'.

The expected return on a portfolio is the weighted average of returns on the assets in that portfolio:

Asset	Proportion	Return (percentage)
Shares	0.30	20
Debentures	0.20	09
Bonds	0.10	07
Mutual funds	0.40	11

Risk-return relationship

- There is no investment instrument without risk.
- Everybody looks for instruments with low risk and high returns. Technically, the market will not allow such an instrument to exist because of a mechanism called **arbitrage.**
- Investments with higher sensible risk are 'expected' to deliver higher returns.
- The higher the 'potential' risk, the higher the 'potential' return.

When investing in market-related instruments, the main risk you face is the uncertainty of future rates of return, which can result in the erosion of your investment. Here's a breakdown of risks, which can be experienced in any combination:

- **Market Risk: the risk that movement in the financial markets will adversely affect your investment value.** You can always be assured of one thing when investing — the markets will fluctuate based on many factors, such as the state of the economy, current events, corporate earnings, interest rate movements, and sometimes even a statement from a high-ranking government official!
- **Interest Rate Risk: the risk that the value of a fixed investment instrument will drop as interest rates rise.** Bond prices are inversely related to interest rates, that is, if one goes up, the other goes down. If you're heavily invested in bonds, the value of your portfolio may be greatly influenced by interest rate fluctuations.
- **Inflation Risk: the risk that the return on your investments will not keep pace with rising consumer prices.** Historically, fixed - rate securities have sometimes not returned enough to protect investors

against inflation, while, over the long term, equity securities have tended to keep up with or exceed it.

- **Business Risk: the risk that a company issuing a security may not be financially healthy due to any number of factors such as poor management,** low product demand, or exorbitant operating expenses. Such situations can result in a plunge in the security's value, as well as a dividend reduction or elimination.
- **Credit Risk: the risk that a bond issuer will not be able to repay its debt at maturity.** Bond ratings by agencies such as CRISIL identify the quality and risk level of bonds. Highly rated bonds tend to carry the lowest risk, while bonds with low ratings, are typically the riskiest.
- **Currency Risk: the risk that fluctuations in between the Indian Rupee and a foreign currency may decrease the value of a security that is either invested in or whose value is derived upon that currency.** Global and international investments are most subject to this type of risk.
- **Political Risk: the risk that political and/or governmental actions or events may unfavorably influence the value of a security.**
- **Liquidity Risk: the risk that a security cannot be sold at a fair price within a reasonable period of time. Shares in large blue-chip stocks are considered liquid because a large number of publicly held shares are actively traded.** As a result, their stock prices are not dramatically affected by day - to - day buying and selling. Conversely, small - company stocks with a few outstanding shares are generally not considered liquid, since a few big buy or sell orders can greatly influence the share price.

All the risks have to be managed – avoiding risk is only a theoretical concept. For example, the equity markets fluctuations can be countered by doing 'systematic investment' in equity funds. You can reduce the interest rate risk by investing in a dynamic bond fund where you hope the fund manager will take the correct calls on the interest rate movements. Inflation risk is avoided (reduced) by investing in asset classes that have traditionally kept ahead of inflation – equities and real estate. You avoid liquidity risk by

being invested in mutual funds – so that you get the withdrawn amount in 3 days time.

Asset allocation: Because various classes of assets do not move up or down in tandem, we invest in various classes of assets. Such behavior of accumulating various types of assets is called asset allocation, which is the process of deciding how much of each asset class a person will have in his portfolio.

Asset allocation is a technique that aims to balance risk and create diversification by dividing assets among major categories such as cash, debentures, shares, real estate, gold and derivatives. Each asset class has different levels of return and risk, so each will behave differently over time. For instance, while one asset category increases in value, another may be decreasing or not increasing as much. For most investors it is the best protection against a major loss, should things ever go amiss in one investment class or sub-class.

Asset allocation is one of the most important decisions that investors make. In other words, your selection of shares or debentures is secondary to the way you allocate your assets to high and low - risk shares, to short and long-term debentures, and to cash.

Bonds or Debentures: A debt security represents a loan by an investor to an issuer. It is a promise by the borrower to pay the lender a certain sum of money on a particular date in the future. The lender gets a consideration for doing this transaction. This consideration is called interest.

Bank and company deposits, national savings certificates, infrastructure bonds, etc. are all examples of bonds. In India, the words ‘bonds’ and ‘debentures’ are used interchangeably. However, bonds can be taken to mean debt instruments issued by the governmental or quasi - governmental bodies and debentures to mean the debt instruments issued by the private sector companies. Interest payments are also called coupons.

Definitions and concepts- bonds

Interest could be paid on a regular basis or at the end of the transaction. Such interest is said to cumulative and is **paid back - ended.**

Maturity value is the value that a lender will get at the end of the holding period.

Yield is the reward that you get on making an investment. In case of bonds, it is interest; in case of equities, it is dividend and capital appreciation of the principal. In case of real estate, it is rent and appreciation of the value of the house. In case of gold, it is the appreciation of the price.

A debt is a promise or an obligation by one party to pay a specific amount of money to another party.

A debt security is a security where the investor's income is pre-determined or fixed in advance.

Credit Risk and Rating: Certain agencies called credit rating agencies rate instruments into various categories such as AAA, AA, BB etc., which signify different levels of risk associated with the instrument. The benchmark yield is provided by the gilt or government securities. The gilt security, being a government instrument, will not default and is the benchmark for other issuers. Other issuers will always pay more interest rates than the government bonds. Use credit ratings – do not invest in an unrated instrument such as fixed deposits or debentures.

Par Value: This is the principal amount paid to investors upon maturity of the bond and is known as the face value.

Maturity date: This is the terms of the bond i.e. the date on which the issuer repays the principal amount of the bond.

Call or Put Provisions: The terms are normally provided at the time of the issue itself and are in the nature of 'embedded options'.

- **A Call allows the issuer to redeem the bonds before maturity, thereby allowing refinance of debt at lower interest rates.**
- **A Put option gives the investors the right to redeem the bonds prior to maturity but after some specified holding period, thus allowing investor to invest in higher-yielding paper.**

Debt classification

We can classify debt as follows:

1. **Tenure:** Government securities (commonly referred to as G - secs) have maturity ranging from less than one year to 30 years. A top corporate in India has successfully issued a 100 - year bond in the overseas market. The tenure of an instrument can thus vary from a few days to a few years.
2. **Issuer:** The government acts as an issuer and issues debt instruments – National Savings Certificate, RBI bonds, etc. are all examples of this. Non - governmental issuers include public sector unit (PSU) companies, financial institutions, banks, private sector companies, corporations, municipalities, etc. The government bonds are the benchmark for other issuers. For e.g. if a government bond for 5 years is currently priced at 6.5%, other issuers will have to pay a rate higher than 6.5%.
3. **Tax status:** Generally, only the government issues tax - free bonds. However, such a status may be granted to some government - owned institutions. All other instruments are normally taxable.
4. **Security levels:** The government of any country does not have to rate its instruments inside the country. Other borrowers need to get it rated by a rating agency. Based on this, instruments can be classified as AAA (highest safety) to D (default category).
5. **Periodicity of interest payment:** This could be a 6 - monthly coupon or a deep discount bond where all the interest is paid back ended, i.e. on maturity.
6. **The interest that a bond pays could also be at either at a fixed rate or at a floating rate.** A fixed rate instrument could be a 6.5% RBI bond and a floating rate bond could either pay an increasing interest, say 6% for 3 years, 7% for 3 years and 8% for the balance 4 years. The

other way a bond could be floating is a private company saying, "The bond will carry 2% more interest than SBI's 3 - year FD rate" on a privately placed bond. Thus, another method of classifying bonds is either a Fixed Rate Bond or a Floating Rate bond.

Issuers

The Central Government is the largest issuer of fixed income securities. Such securities are called gilt - edged securities or gilts (sovereign bonds). They form the benchmark in the country for the others to price their own bonds or debentures.

Risks of investing in bonds

Interest-Rate Risk: When interest rates rise, bond prices will fall. The existing bond portfolio will lose value & vice versa.

Reinvestment Risk: Risk is of interim cash flows being reinvested at a lower rate. What it means is that if you have kept a fixed deposit of say Rs. 500,000 at 12% interest. You will get Rs. 15,000 a quarter – however, if you try to invest the interest that you have got you may now get only 11% interest. In the next quarter, the interest may fall further and so on.

Call Risk: If issuer calls back call option bonds, when interest rate falls, they can be replaced with cheaper debt. The investor will not be allowed to stay invested in a high - coupon bond.

Default Risk: The issuer may default on its obligation to make timely principal and interest payments.

Inflation Risk: When inflation rates rise, the value of interest payment is reduced. Higher interest rates will make the existing bonds lose value again.

Liquidity Risk: This is the ease with which investment in a bond can be liquidated at a price near its value. It is important as a fund may require to sell a part of the portfolio to meet redemption demands.

Elements that have a bearing on interest rate movements

1. **Inflation**
   Inflation is the cost at which money is available in the economy, generally measured by the Wholesale Price Index although the Consumer Price Index is also tracked.
   As inflation rate rises, money becomes dearer, leading to an increase in the general level of interest rates.
2. **Exchange Rates**
3. **Policies of the Central Bank**
   The RBI's policies have a strong bearing on interest rate levels in the economy. It could impose a higher liquidity ratio on banks and institutions. This would restrict credit, leading to an increase in interest rates.
4. **Interest Rates in Other Countries**
   This element affects all countries. For e.g. if the US increases its interest rates, India will have to follow suit.

Equity capital represents the 'risk' capital of a business. When an entrepreneur sets out to do business the amount of capital that he invests is the risk capital. Since it represents the owner's capital, the shareholders have voting rights in the business. Apart from providing a sense of security to the lenders, it acts as a cushion in case of the diminution of value of assets.

Equity markets :
Equity capital is the capital contributed by owners or shareholders. Equity or shares represent a unit of ownership in a company. Companies raise equity capital by issuing shares. Equity shares once issued have a life - long tenure until the business exists.

Equity can also be explained as an asset class where the liability is limited up to the initial contribution but benefits are from the upswing. The residual value of business belongs to the equity holders i.e. if a business is being wound up, first the secured creditors will be paid off, then the unsecured creditors will be paid off, then the preference shareholders

will be paid off and the balance left, if any will be paid to the equity shareholders.

Some Features of Equity

As long as the business survives, the equity capital stays invested. In some cases, companies may buy back some of the equity capital that it issued. Equity owners have voting rights and can participate in management.

Equity owners earn returns on their investment in two ways:

1. **Dividend:** Periodic payments made out of the company's profits are termed as dividends.
2. **Capital gains:** This is the change in the price of a stock since you bought it.

Buying equity

Equity can be bought either on the primary market during an initial public offering (IPO) or on the secondary market, the stock exchange.

Primary market

The primary market is a market where new issues of shares, debentures and bonds are launched. Investors apply to the issuer for allotment and pay application money. The transactions in the primary market result in new capital formation i.e. the company typically uses the money received from the investors to invest in building new infrastructure or expand/upgrade the existing one.

If the company is issuing its equity shares for the first time, such an issue is called an **Initial Public Offer or IPO.** If an existing equity holder in a company wants to raise money or capital by way of equity, it can also sell shares to the investors. Such an issue is called as a **Seasoned Offering.** In the case of an IPO, the pricing of the shares is based on the assessment made by the company, the investment bankers and investors. In the case of a Seasoned Offering, since the shares are already listed and traded in the market, the pricing is driven by the prevailing market price of the share.

Secondary market

The secondary market is a market for the secondary sale of securities. In other words, **it is a market where existing securities are traded.** This market trades government securities and corporate shares and debentures. Investors are free to buy and sell the shares at their own will. This market provides investors with liquidity, where they can sell their existing financial securities and convert them into cash at the existing market price.

When a company makes profits, it may decide to re - invest part of the profit into the business and distribute the rest to its shareholders in the form of dividends. If the company performs well and promises future growth and profits, the price of the company's shares will rise. The shareholder can then sell his shares in the market and capture this rise in the value of the company shares. This is called **capital gain.**

Rights issue, bonus shares, stock splits

When a company issues additional equity capital, generally, it has to be offered to the existing shareholders first. **A rights issue is like selling shares in the primary market to the existing shareholders.**

Bonus shares are shares issued to existing shareholders because of capitalization of reserves. A bonus issue is made out of free reserves built out of the profits or from the share premium collected in cash.

In a stock split, the par value per share is reduced and the number of shares is increased proportionately. This is usually done to bring the market price within a more popular trading range. Take the case of a company who has initially issued 100,000 shares at a par value of Rs.50 each. The company decides to go in for a stock split in the ratio 5:1. Its outstanding shares now increase to 5,00,000 at a par value of Rs.10 per share.

Cyclical stocks

These are shares of whose earnings are correlated with the state of the economy. Their earnings / share prices tend to go up during upward economic cycles & vice versa. For e.g.: cement or aluminum producing companies have lower P/E ratios and higher dividend payouts.

Identifying and investing in such currently under - valued stocks that can yield superior returns later is the process of Value Investing.

Approaches to Portfolio Management

Passive Fund Management: Index Funds
The objective in passive fund management is to equal the return on a selected market index.

The fund manager must purchase all of the securities forming part of index in the same proportion as their share in the index. To explain, the manager must purchase a statistically representative sample of stocks whose combined total return will be close to the index.

> **Growth stock:**
> **Shares of whose earnings are expected to increase at rates that exceed normal market levels.** They generally reinvest earnings, have a high P/E ratio and low dividend yields.
>
> **Value stock:**
> **Shares of companies in mature industries have low - yield growth in earnings and have assets whose values have not been recognized by investors.**

The Fund Manager has to:

- ✓ Rebalance the portfolio to remain in line with changes in the index composition.
- ✓ Keep the fund expenses as low as possible, so that investors get returns close to the index return.

Active fund management
This includes two styles: growth investment and value investment.

Growth Investment Style: A growth manager looks for companies that are expected to give above - average earnings growth. Builds portfolios with

higher potential returns but lower risk and looks for the earnings prospects to fuel growth.
Value Investment Style: A value manager buys companies that he believes are currently undervalued in the market whose worth will be recognized in the market valuations eventually.

Such a manager aims to cash in on the capital appreciation by selling shares when the **"unlocking of the value"** takes place.

Fundamental analysis
This type of analysis involves research into the operations and finances of a company, or the fundamental blocks of the company, to estimate its future earnings. Factors such as the company's position relative to other industry players, impact of the regulatory environment and quality of management are also considered.

Technical analysis
This type of analysis involves the study of historical data of the company's share price movements and trading volume. Factors such as market sentiment and trends in supply/demand are also considered.

The objective is to recognize patterns in the market price behavior and use that knowledge to try to predict the future course of the market price of a share, or even an industry.

Mutual funds concept & role
Mutual funds act as a link between investors and financial markets by mobilizing savings from units having a surplus and make it available to units needing money.

The image in India when you say 'mutual fund' is an instant recall of equity markets. This is far from the truth. The reality is that the mutual fund industry has more than 70% of its assets in debt instruments!

Concept of a Mutual Fund
To put it simply, a mutual fund is the pooling of money and mutuality; like - minded investors come together and invest for their own benefit.

Fundamental Analysis forms the basis of a fund manager's decision on whether to buy a given share. Technical Analysis would guide the decision on the right timing to make the investment.

Advantages of Mutual Funds

- ✓ **Portfolio diversification: for a small sum of money you can buy a small part of a large number of shares.**
- ✓ **Professional management: asset management companies use professionals to manage the money.**
- ✓ **Reduction/diversification of risk: By investing in a group of companies, you avoid risks such as one company becoming insolvent and taking all your money along.**
- ✓ **Reduction of transaction costs: for most retail investors, investing through mutual funds is a far cheaper alternative.**
- ✓ **Liquidity: Accessing your money can be very easy and in 48 hours, you will get the amount transferred to your own savings bank account.**
- ✓ **Convenience and flexibility: a direct equity portfolio creates a lot of pressure e.g., you need to deposit the dividends, you need to provide cash to pay for the rights issues or you need to review your portfolio!**

Disadvantages of Mutual Funds

- **Significant costs:** in India, even Exchange Traded Funds (ETFs) and index funds do not come cheap. However, it is true that mutual funds cost you less than the mistakes that you could make while trading/investing.
- **Numerous schemes:** You may not know why there are more than 1,000 schemes in existence in equity funds alone! Selecting a good scheme in this jungle of schemes is not easy.
- **Investing too much:** if you have invested at various points in time, you may have to manage a portfolio of funds. This beats the whole

purpose – instead of life getting simpler, you have to monitor your portfolio!

Classification of funds

Open - Ended Funds

The fund house always has units available for sale and purchase from the existing corpus. Most funds in India are structured as open - ended funds. As the corpus is used to redeem and new money is added to the existing scheme, the corpus varies on a day - to - day basis. This makes the Unit Capital variable. The number of outstanding units goes up or down – and the unit's sale/purchase is at NAV price per unit.

Close-Ended Funds

Money is raised by a one-time sale of fixed number of units. Transactions — buying and selling — normally happens through a stock exchange. The number of units is fixed. However, a bonus, split and a buy - back can cause the total number of units to vary: there is no day - to - day fluctuation. Units trade (normally) at a variance to the NAV — based on expectation of future performance and market factors of demand supply conditions.

Classification by Nature of Investments

- **Equity Mutual funds:** These largely invest in equities.
- **Bond funds (Income funds):** Debt funds which invest in mid - term debt instruments. It is used to defer tax on debt earnings.
- **Money Market mutual fund:** Invests in debt instruments with a very short maturity. Normally large amounts of money are invested here with short time duration.
- **Commodity Funds:** In India, gold is the only commodity fund that has been allowed to participate as a commodity. Other commodity funds invest in companies, which are in the commodity manufacturing business. Going forward, there could be precious metal funds and real estate funds - subject to the guidelines and rules of SEBI.

Classification by investment objective

- **Growth:** Equity funds are called growth funds – when you invest in equities, you are supposed to be investing in 'growth', hence the name.
- **Income Funds:** Normally, debt funds are called Income funds – this is because investing in debt is thought to be investing for getting interest income.
- **Value Funds:** These funds pick stocks that are currently under-priced and those who have a great value embedded in the price. Normally, the decision to buy or sell is taken based on price - to - book value and price - earning ratios.
- **Contra funds:** Schemes which buy funds currently out of favor, but likely to do well in the future.

Classification by Risk Profile

Nature, Investment Objective and Holding Period of the portfolio imply the different levels of risk undertaken.

Money market funds

These funds have the least risk of principal reduction, but have a very high risk of income fluctuation. It invests in short-term papers with maturity less than one year, and normally invests in T - bills, Certificate of Deposits, Commercial Paper, inter - bank call money market, etc. chosen for liquidity and safety of principal.

Debt funds (or income funds)

These funds invest in debt instruments of the government, private companies, banks, financial institutions and infrastructure companies/utilities. They invest in fixed income generating instruments and normally provide a high level of current income. They carry default risk — that some of the borrowers will not pay — and the risk of price fluctuation due to interest rate changes.

Gilt funds (Government Securities)

These funds invest in government papers with a longer maturity (called Dated Securities).

These are risk - free as there is no risk of the government defaulting.

However, price (net asset value) changes based on changes in interest rates.

Types of Debt funds

- **Diversified Debt Funds: They invest in all types of debt issued by all industries and sectors.** They reduce the risk by diversifying across industries and investing only in rated funds. They run interest rate risk, default risk and inflation risk.
- **High Yield Debt Funds: These invest in slightly lesser quality of debt paper compared to normal debt funds.** Only one such scheme exists in India.
- **Fixed Term Plan Series or Fixed Maturity Plan (FMP): This Indian variant tries to eliminate interest rate risk.** The date of maturity is known in advance, is similar to a fixed deposit and has a distinct tax advantage as compared to a bank fixed deposit. It is typically a close - ended fund with maturity of 12 -18 months – although occasionally some FMPs with greater maturity are also launched. It is mandatory for these funds to be listed on the stock exchange and they cannot give any 'indicative' returns.

Specialty Funds (Focus Funds or Sectoral Funds)

These funds have a narrow portfolio focus in a particular industry – pharmaceutical, FMCG, banking, infrastructure, etc. Choosing these stocks requires market timing skills unlike a diversified fund.

Diversified Equity funds - ELSS (Indian Variant)

These investments allow you to claim an income tax rebate. However, investment in such a fund should be made only with a 7 - 8 year view on equity markets.

Equity Index Funds/ETFs

This fund invests in an equity index portfolio - in the same shares in the same proportion as the index. The risk is the overall market risk.

Equity funds
In equity funds, the NAV (Net asset value) fluctuates with market price movements. It is suited for individuals with higher risk appetite and does not guarantee returns. The catch is that, if chosen properly, these funds have a high potential for returns. Capital appreciation can be expected over a 7 to 10 - year period. The performance could be volatile and the return from one fund to another varies depending on the fund manager's performance.

Hybrid Funds - Quasi Equity / debt
These funds comprise debt, convertible securities, and preference and equity shares in a pre - defined proportion. The fund aims at moderate capital appreciation, preservation of capital, and some regular income – it has a conservative and long - term orientation. Typically, children's plans and retirement plans are structured like this.

Mutual Fund Structure in India
If you have heard from many sources that, "Mutual fund investments are safe" and you have wondered why, here are the reasons. The fund industry is structured to include a fund sponsor, asset management company, the fund — a Trust, board of trustees, board of directors, auditors, custodian, transfer agents — and their functions are arranged in such a way that it makes the industry safe.

Let us look at their roles!

The Fund Sponsor
This role is similar to the promoter of the fund who sets up the Trust and appoints the Board of Trustees. He/she appoints the custodian and helps the registration of the fund with SEBI. Then the trustees appoint the asset management company. The fund sponsor holds at least 40% of the net worth of the asset management company.

Mutual Funds as Trusts

The mutual fund holds money in a separate account as a trust.The trust is the 'legal' holder of all the assets, which are held for the investors' benefit. The unit holders are the beneficial holders of the shares and the trust is the legal owner. It is registered as a Public Trust under Indian Trust Act, 1882. Trustees have legal standing and have a duty of safeguarding the assets of the unit holders. Money held by the trust is in a fiduciary capacity through money held by trustees on day - to - day basis.

Trustees

Trustees are appointed by the Sponsor with the main task of safeguarding the investor's interest. The majority of the trustees are independent; they meet on a quarterly basis and review the working of the asset management company.

Asset Management Company (AMC)

An AMC has to have a net worth of Rs. 100 million, and is not permitted to engage in any other business. However, it can undertake portfolio advisory services.

Other Mutual Fund Constituents

Custodian and Depositories

These are appointed by the Sponsor: they act as the registered owner of securities, keep physical custody of securities, and the dematerialized shares with the depository participant, and act on (securities and funds) instructions given by the AMC.

Bankers

They hold the mutual fund's money, and provide banking services such as collection, remittance, etc.

Transfer agents

They are appointed by the Trustees; they register you as an owner of the securities, send you the periodical statements, issue and redeem units, update investor records, keep transfer records, etc. Funds can do it in - house or outsource the whole operation – currently, it is outsourced.

Intermediaries
These persons get the form to you, help you understand the product and help you buy the right fund. These could be individuals or big companies including banks.

Fund Managers
These employees of the asset management company actually buy and build the portfolio necessary for you to get a good return on investments. Fund managers are strategists who decide how the portfolio should be structured, and take overall responsibility about how much exposure to take to which industry, and which company. They ensure that the investments remain in line with the scheme's objectives.

Other types of financial assets

Savings and Current accounts: Money is kept here as a temporary parking space for money. Most people leave large balances here as a matter of laziness, and not as a matter of strategy! It is convenient for conducting transactions. You can withdraw money – literally in any part of the world – by using conveniences such as a debit card or an ATM card. It is extremely popular and urban India is well banked with branches at every corner catering to the person using a savings/current account. Since the money can be 'demanded' at any time these are also called **Demand Deposits.** Savings bank account balances attract interest rates in the region of 3-4% per annum.

Fixed deposits: This is money kept with a bank for a pre-defined period of time. Such deposits are kept for 30 days, 46 days, 1 year, and 3 years. It is extremely popular, especially with older people, and has fantastic liquidity.

Corporate Debentures: Companies use this instrument to raise money in the form of debt. Normally, the assets of the borrower secure debentures. These instruments are subject to credit rating. The riskier borrowers pay higher interest rates – so be careful while investing. The credit rating tells you about the level of safety of the instrument – the best are rated AAA and can go as low as D (default category). Big issues could be placed directly

with big funds such as mutual funds and life insurance companies. Some companies also come out with a public issue for public participation.

Government products

Kisan Vikas Patra: This was introduced as a post office scheme to tap savings in rural India. The interest is taxable and suitable for hiding investor identity. It is easily transferable and liquid.

RBI Relief Bonds: This is a popular investment option for high net worth individuals. It pays interest at 8%, which is taxable. It has a maturity period of 5 years, and is free of any default risk.

> **Public Provident Fund- the most popular retirement plan for Indians!**
>
> **This option is totally risk - free, with no default risk and government guaranteed tax - free interest of 8% per annum. The annual contribution (between Rs. 500 and Rs. 70,000) is compounded over 16 years. It is eligible for tax rebate under Section 80 C, with partial withdrawals from the 7th year onwards.**

CHAPTER 25

Mathematical Case Studies

CHAPTER

Mathematical Case Studies 25

- Some math, more comprehension

Mathematical Case studies

Case Study 1:

Estimating future expenses:
Mr. Bhaskar is an executive who is 29 years old. He has recently got married and his annual expenses are Rs. 272,000. Out of this Rs. 72,000 is his EMI for a house that he had bought 5 years back. He estimates his annual expenses to continue at Rs. 200,000 adjusted for inflation. He expects to work till his age of 60 and wants to provide for his post retirement life – which he estimates to be till age 85 years. He wants to provide for inflation at 6% p.a throughout the 56 years that he expects to live. He expects to earn 8% per annum after tax on his retirement corpus.

Questions: How much will be his post retirement expenses?

Using the compounding formula (P = A*(1+r)^n)

Where A = Rs. 200,000, r = 6%, n = 31 years.

His annual expenses at his age of 60 will be Rs. 12,17,620. What should be the corpus that he should accumulate to retire?

The corpus that he has should be ready at his age of 60 years, be sufficient for him – and should last for 25 years post retirement and provide for

inflation at 6% per annum.

Though the solution is being simplistic in making an assumption we have to find the real rate of return that he will get on his principal i.e. (1.08/1.06) -1 * 100 = 1.89%.

He will need Rs. 2.45 crore as a corpus where he can withdraw till his age of 85 years. The end corpus will be very small – however he will have no money if he lives beyond his age of 86 years.

For achieving this corpus he will have to invest in an equity fund – he can put it in equity funds completely for the next 21 years (when he turns 50). This could be a combination of 70% in large cap fund, 20% in a mid cap fund and 10% in some sector fund.

Once he is 50 he should pull out about 30% and put it in debt instruments. Then every year he should put 1% into debt funds by redeeming some equity fund in which he has invested. (see table on age wise investing)

How much does he have to invest?

Welcome again to Excel – if you go to 'Insert' and find the fx – the function key where rate is .08/12 (converting for monthly); Nper = 31*12 (31 years – we are trying to find the monthly contribution) Pmt = - 180000/12 i.e. Rs. 15,000 per month.

If you find it difficult to set aside Rs. 15,000 per month, start with what ever number you are comfortable, you can always increase it later on.

Case Study 2:
Mr. M Mehta is saving Rs. 15,000 per month for the past 5 years and will continue to make this contribution for the next 20 years – till his retirement. What will be the corpus accumulated at his retirement? He is investing this

money in a balanced fund with 65% in equity and 35% in debt instruments. He has opted for the growth option and he is expecting to get 16% return – and there will be no taxation.

Answer: Assumption of 16% return over a period of 25 years is not a great assumption to make, but for purposes of calculation we have used this number. If you are not comfortable with 16%, plug in a smaller number. Using Excel:

Rate = 0.16/ 12; Nper = 20*12; Pmt = -180000/12

Will give you the figure of Rs. 2,58,96,625.

Now if you are saving Rs. 7500 per month you will have half the amount and if you are saving Rs. 30,000 per month, you will have Rs. 5.16 crore!

If Mr. Mehta with an accumulated corpus of say Rs. 2,58,00,000 were to withdraw Rs. 92,000 per month what corpus will be left with him at age 85 years? Make an assumption that the corpus will earn interest at 8%. Inflation will be at 6% during this period.

Using an excel sheet and assuming that all years will have the same inflation (6%) and the same return on investing (8%) and Mr. Mehta will start spending from his corpus at age 55, he would have a corpus of Rs. 1.6 crore.

Case Study 3:

Mr. Swanand is 36 years old and his current monthly expenses are Rs. 26,000 a month – not including his EMI, and child's school fees. He wishes to maintain his same standard of living after retirement at 60 (he is worried he may have to quit at 55). His life expectancy is 80, but his wife (non - earning) is 9 years younger to him. He wants the money to last till his wife's age of 83 (i.e. his age of 92 years).

He is assuming that inflation will be at 6% per annum, but his investments will give him a return of 8% per annum (i.e. he is expecting to get a 2% real return).

How much should he invest per month?

Solution:
Using excel, where PV = 26,000 * 12 = 312,000

Mathematical Case Studies
I = 6 % n = 19 FV = 943,987 (will be his annual expenses at his age of 55)

Using excel he will need a corpus of 2.5 crore. This will allow him to have a very small corpus at his age of 93.

To create a corpus of Rs. 2.5 crore, he will need to do a SIP very aggressively in a fund with about 70% in equity and 30% in debt, and once he reaches the age of 47 - 48 he should review his portfolio. The amount of SIP to be done is:

Using excel: rate = .08/12, nper = 19*12 amt = 48000 gives you the SIP amount. This will create the corpus required for Mr. Swanand to retire.

Mr. Swanand found this very difficult at the current juncture. However he was banking on the ESOP of his bank – it was already worth Rs. 12 lakh – and was doing well. So he hoped that his ESOP would be worth Rs. 1.25 crore by the time he retired, so he needed to invest only Rs. 24,000 per month. He was also confident of his PF adding up to a tidy sum – and since that was in debt he started a SIP in a Unit linked plan with a very low asset management charge. This was a pure equity plan, and Mr. Swanand was willing to top it up now and again so that he could see the corpus in place by his age of 53.

Case Study 4:
Mr. Avishek invests Rs. 15,000 per month in a unit linked plan for 30 years. He is 35 years old and is expecting to retire at the age of 60. He also contributes Rs. 10,000 a year to his public provident fund which he hopes to keep alive till his age of 60 years. He would like to provide for 20 years after retirement. He assumes that he will be able to get 12% on his equity SIP and 8% in his public provident fund. He also assumes that he will inherit an equity portfolio from his father (currently aged 70 and expected

life of 80) which is currently worth Rs. 15 lakh. His father lives on his pension and the dividends and is not likely to touch the corpus during his life time.

a. What will be the accumulated amount at age 60?
b. How much can he safely withdraw till age 80? Post retirement he expects his portfolio to earn 8% after taxes.
c. He is currently spending Rs. 50,000 a month on his personal expenses. Assuming the same spending pattern and 6% inflation how long will the corpus last?
d. If he dies at 75 what will be the corpus at that age?
e. If he wishes to leave Rs. 1 crore at his death to a charity how much can he afford to withdraw every year?

Solution:

a. Using excel Future Value calculator:
Rate = 8% Nper = 25 years Pmt = -10,000 gives you a future value of 731,059. This will be the amount accumulated in his public provident fund by the time he is 60 (25 years from now).

His father's equity portfolio future value will be:

Rate = 12%, Nper = 25 years PV = 15,00,000 FV = Rs. 2.55 crore.

His Unit linked Plan would have accumulated:

Rate = 12% per annum, Nper = 25*12, Pmt = -15,000.

He would have accumulated Rs. 2.82 crore.

Thus the total corpus that he would have at his age is 7.3 lakhs + 2.55 crore + 2.82 crore = Rs. 5.44 crore.

b. His monthly expenses adjusted to inflation will be Rs. 214,595. He will be able to easily maintain this till his age of 80 and still leave a

corpus of Rs. 3.5 crore at his age of 80. If he spends Rs. 231,761 from his age of 60 till his age of 80, he will exhaust his corpus.

c. At the current expenditure of Rs. 50,000 his monthly expenses will be Rs. 214,595. This he will be able to spend till his age of 83. At his age of 84 he will not have enough money to spend. At some stage he may have to reduce his expenses if the thinks he will cross his age of 83.

d. Spending the way he is currently spending if he dies at 75, he will be left with a corpus of Rs. 6.3 crore.

e. For leaving Rs. 1 crore to charity (at age 80) he can afford to spend Rs. 229,615 per month from his retirement corpus. At his current spending levels he can afford to leave Rs. 3.5 crore.

CHAPTER 26

Portfolio Makeover for Retirement Case Studies

CHAPTER

Portfolio Makeover for Retirement Case Studies 26

- Real-time simulations for a clearer picture

At retirement most portfolios will need some makeover – to adjust for creating income apart from protecting for inflation. Here are some case studies.

"A man's errors are his portals of discovery"
- James Joyce

Case Study 1

I recently received a letter from Jayshree Mathur, a 56 - year - old widow who lost her husband last year and is retiring 2 years from now. That is a lot of change happening all at once – emotionally and financially.

Jayshree writes, "I'm trying to figure out the best way to make my money last for 30 years." She had many questions:

- Should I pay off my mortgage of Rs.19, 00,000 at 7.75% or invest that money?
- Is my asset allocation correct since my only source of income will be interest and dividends?
- Do I need a financial advisor or can I do this myself?
- Should I listen to my banker who sends me an email at least twice a week?

Transitioning into retirement is probably one of the most vulnerable times in anyone's financial, and perhaps, emotional life. Jayshree wanted a quick fix for all her financial issues. Her own salary is not too high and her lifestyle was dependant on her husband's salary. I asked her to meet me with details of her portfolio.

I always like to start with a quick snapshot of an investor's personal balance sheet, goals sheet – needs, wants and luxuries. Fortunately, Jayshree had her cash flow, income and expenditure account, and list of assets and liabilities ready. She made this process easy by using a software package to track her finances.

Reworking the portfolio: Although Jayshree has a healthy nest egg, she will need to make significant changes to her portfolio, in part, to invest the life insurance proceeds, and in part, to help her transition into retirement. I spoke to her about her risk tolerance, and she is somewhere between conservative and moderate. She and I discussed using either a balanced mix of equity and debt funds (50% income, 50% equity) or a more growth - oriented mix (40% fixed income, 60% equity). We both agreed the growth mix would be better for her.

She has more than enough liquidity and a solid nest egg for retirement. Luckily, she and her husband were both involved in the investment decisions. It also helped that I had mostly met them together so she had an idea of what I had done. She was also happy that I had simplified her father-in-law's portfolio, which she and her husband inherited after his death (her father–in-law had invested in 37 companies and 18 mutual fund schemes; I reduced it to 5 companies and 3 schemes).

Let me highlight a few of the issues I came across in Jayshree's portfolio.

1. Jayshree knew she had too much stashed in cash. I left her a comfortable balance of Rs. 1 lakh in her savings account and another Rs. 2.4 lakh in her floating rate fund. That is approximately 18 months of her expenses.

2. We decided to hold another Rs. 5 lakh or so in short - term bond funds. This adds an additional layer of liquidity to her portfolio and could potentially cover another 3 years of expenses providing for some inflation too.
3. Her bond holdings include short - to intermediate-term bonds, a high - yield bond fund, FMPs, RBI bonds and investments in Postal schemes. Overall, her proposed bond portfolio will generate about Rs. 5.14 lakh in annual income.
4. Jayshree has one daughter, qualified, married and living with her husband in the US. Jayshree sees no reason to consult with her regarding her portfolio – except to say that the will needs to be updated favouring her daughter, Jayshree's younger sister and some charities.

I recommended that Jayshree sell a number of individual stocks in her portfolio. Although I rate many of these stocks highly, it was a portfolio created by her husband. Jayshree had neither the love nor the interest in equities to handle an equity portfolio. Luckily, she was not emotional about either holding or selling off, so it became an easier task. The sale of shares yielded about Rs. 2 crore. Jayshree's expectation from the sale of shares was about Rs. 80 lakh only.

Jayshree had a unit - linked life insurance plan. She believed it was an investment, with life cover thrown in free. I created an illustration and showed the risk and mortality charges. She was appalled, but she had signed the form!

There were two questions to ask: First, would she incur a surrender charge to get out of the plan, and, second, could Jayshree roll this plan into a pension plan? While talking to her, I learned that she had held this plan for five years and there was a surrender charge of 5%. She will need to find out the penalty in moving this money out of the plan now. Regarding the second issue, she could not convert it into a pension plan. Jayshree had no idea about the exit load – she had not asked of course.

A retirement projection can be one of the most important tools to use when you are trying to make important decisions such as paying off the mortgage

or determining how much is reasonable to spend in retirement. By simply entering her portfolio into an excel sheet, I tried to calculate Jayshree's money requirement in retirement. To be conservative, I used single-digit rates of return on all asset classes and a life expectancy of 91 years. Her total expenses are about Rs. 4.5 lakh per year including mortgage payments. The mortgage will be completely paid off in 5 years. She can meet these expenses in part through her portfolio income. Part will need to come from withdrawals from her cash - equivalent pools. Jayshree would draw from her taxable assets first and let the retirement assets continue to grow tax - deferred as long as possible. This means she will live off her RBI bonds, National Savings Certificates (NSCs) and bank interest, and not touch her money in a Pension Plan and other mutual fund schemes.

We calculated the feasibility of paying off the mortgage now and found that it made sense because this payment would come hugely from the debt portion of her portfolio. Jayshree was confident about doing that – she also wanted to have as few documents to handle as possible. So, despite the fact that the average weighted return on her portfolio would have been higher than the 7.75% that she was currently paying (fixed rate), she paid off the mortgage.

Summary

Retirement planning is quite a complex task. It encompasses portfolio planning, tax planning, behavioural science and individual psychology. Jayshree wanted to know whether she needed a portfolio manager, a financial planner, a Chartered Accountant, a broker, etc.

Even though her husband had nominations for all his assets, Jayshree had no clue what each advisor's role was. I explained that she no longer needed a portfolio manager, as the shares were sold off. She no longer needed a financial planner on a monthly retainer – an annual review was sufficient. She would need a CA to file her tax returns. She would not need a broker – for equities or mutual funds – as she was in redeeming mode, not investing mode! A simple E-broking account would more than suffice.

Case Study 2

I was aghast when Capt. Ajoy Athalye walked into my office with his wife Sunita, and announced that he wanted to buy a Rs. 1 Cr. commercial space in a suburb of Delhi.

Aghast because he had shared his portfolio with me a week earlier to remedy it. He and Sunita were employees of a very big airline based in India. He was a pilot who earned quite well – Rs. 77 lakh a year. His wife had a well paying ground job in the cargo section and she was earning about Rs. 24 lakh a year. One would expect that a high - income couple at the age of 52 years, to have stashed a couple of crores in assets apart from the house in which they live.

I was shocked to learn that the Athalyes had about Rs. 8 lakh in mutual funds and about Rs. 4 lakh in public provident fund, NSCs, etc. Of course, he had Rs. 30 lakh in his provident fund and his wife too had about Rs. 12 lakh in her provident fund account.

If this was the case, where did the money go?

Well, it went to fund the education of his children. He had spent Rs. 50 lakh on making his son an MBA (from Australia). His daughter wanted to become a commercial pilot and that set him back by Rs. 55 lakh. His flat had cost him about Rs. 30 lakh and now had a market price of Rs. 2 crore. He wanted to know whether he could retire in 8 years time and Sunita in 12 years time.

Their monthly expense was Rs. 1 lakh a month. This included the expenses for both children: the son wanted to study further and his daughter was doing a computer course with NIIT, as commercial pilot jobs were not available.

Now, Capt. Athalye wanted to buy a commercial space in a new place and was wondering how to fund it. Some clients, although smart in their professional life, can be blind when it comes to their financial health. Taking on the role of a doctor, I told them the following:

- Do not take your job for granted.
- Your children are your pride, glory and joy. However, there has to be a time when you cut the apron strings and let them be independent.

- You have no life insurance, and your accumulated money will last exactly 24 months from the date of separation from the company.
- The current portfolio will sustain you for 2 years if you retire at 60 years, and not at all if you lose your job today.

Unfortunately, he did not take to this advice very well. He countered by saying he could borrow against his existing house (Loan Against Property - LAP) and fund the new commercial property. He would then give the commercial property for rent – and the rent would be able to pay the EMI. And, in the worst case, if he lost his job he could always get a reverse mortgage.

I was appalled. Luckily, excel came to my rescue – the EMI on the LAP was about Rs. 1 lakh per month for 8 years. The rent he could get was Rs. 14,000 for the property.

He did not realize that reverse mortgage was available only after the age of 62 years, so he was about 10 years away from that. Moreover, his flat would be about 26 years by the time he was 62. This meant his flat would not be eligible for reverse mortgage.

The last I heard, they were looking for a new advisor. After all, who wants to hear the truth?

Case Study 3

Pooja Ahuja was just back from a vacation with her mother. They had been to Mansarovar – at 70, Pooja's mother, Poonam Ahuja, was 12 years older than the second oldest participant! The good news is that Poonam is in good health. She has an optimistic outlook on life and enjoys travelling and living well. She spends a lot of time travelling to meet her 3 siblings who live in various locations. Pooja is her only daughter and Poonam lives close to her in Coimbatore. Longevity runs in her family. Pooja says she will not be surprised to see her mother cross 100 years!

The bad news is that Poonam's portfolio, managed by Pooja, has fallen – like most equity portfolios!

Pooja is worried that she is touching the capital too early – and the capital may not last until her mom is 100! Worried about this, Pooja wanted to reposition the portfolio for greater safety, income and some growth – to at least match inflation.

Poonam's Portfolio before Repositioning:

	Market Value	Total	%age	Income
Reliance Industries	100000			
Coromandel Fertilisers	200000			
L & T	100000			
Eid Parry	100000			
Deccan Gold	12500			
H K Fine Chemicals	12000			
Crest Animation	27000			
Miscellaneous	112000			
EQUITIES		663,500	26.62	12000
Mutual Funds				
Equity				
Franklin India Blue Chip	150000			
HDFC Top 200	175000			
Reliance Growth	35000			
Magnum Contra	10000			
Magnum Global	15000			
Magnum Taxgain	12000			
Reliance Power	12000			
Reliance Pharma	13000			
Fidelity Opportunities	11000			
Franklin India Opportunities	19000			
Total MF Equities		452000	18.13	6000
Mutual Funds - Debt				
Templeton FMP	47000			
HDFC FMP	46000			
DSP FMP	39000			

Total Debt MF		132000	5.30	12000
Post office	500000			
Banks	500000			
Cash	245000	1245000	49.95	100000
		2,492,500	100.00	130000

Over the past 24 months (on the death of her father), Pooja has been managing Poonam's portfolio and trying to reduce the 'risk' in her mother's portfolio.

A cursory glance told me that her father's style and Pooja's style clashed! Her father had invested large sums of money in few funds and shares, and Pooja was doing the opposite. Her father had picked up good scrips – Reliance, Coromandel Fertilizer, EID Parry. He had also picked up Crest Animation, Deccan Gold etc. He had invested only about 25,000 in each scrip – the values you see are because of the appreciation. Similarly, in the case of mutual funds too, her father had invested (through a SIP) only in Franklin India Blue Chip and HDFC Top 200. His SIP (from his pension!) in Reliance Growth was cut short by his death.

Pooja relied on a friendly neighbor who doubled as a financial advisor. He made Pooja invest in a long list of mutual funds – and very small amounts at that! Poonam is now busy throughout the year filling up forms, paying-in-slips (all are dividend pay out schemes!).

Recommended action

Exit all direct equity holdings!

Poonam is sadly not entitled to any pension from the company scheme. Neither does she have any medical cover. Poonam was lucky enough to have a valid medical cover for the past years on which she has not made any claim.

She has been reworking her portfolio to include more income producing assets, while working to reduce the income she receives from her bank account and post office. Poonam's portfolio, thanks to her husband, includes some good individual holdings like Coromandel Fertilizer and EID Parry.

Still, Poonam's portfolio is very aggressive given her age. Her asset allocation includes cash in the bank account – but just 53% is in debt instruments. Poonam holds approximately 25 individual stocks. Her husband bought most of the good ones that have had appreciable capital gains. Pooja has just dabbled in too many shares – and bought without a strategy. She has no reason to invest in high beta shares with no clue about what the company does. She is guilty of trading – and converting the bad trades into a long - term portfolio! Her stock portfolio skews very heavily towards the "I do not know why I invested" side!

Pooja agrees that her mother's portfolio should be far less aggressive. Although she needs some inflation protection, she should completely exit direct equity. To Poonam this is difficult – her husband had bought most of the shares and she could not part with shares like Reliance

– he paid Rs. 1,250 for it and now it is worth Rs. 1 lakh! More importantly, Pooja was concerned about selling stock holdings at what could turn out to be a market low.

I was happy that Pooja agreed to my advice of shifting from equity to debt – at a time when the Sensex was at 16,000 – that was sheer luck! Then the market dipped to sub - 9000. Of course, at the time of writing the index is almost back to 15,000. Nonetheless, there are no guarantees that shares will turn around quickly.

My advice is to reduce the direct equity holdings; just drastically prune it! Pooja has no portfolio handling skills, unlike her father. I have just left a couple of good equity shares – partly for emotional reasons. I have also left the mutual fund investment – but internally sold off all equity funds other than one blue chip fund and a Top 200. All the proceeds have gone into 3 debt funds. Poonam will meet her day - to - day expenses from dipping into these funds too apart from her post office interest and bank interest.

I also increased her bank fixed deposits and postal schemes. Poonam is now a senior citizen – and hence does not have to worry too much about income tax. She needs a cash flow of at least Rs. 1.8 lakh – and subject to inflation, at least at 6-8% per annum and some uninsured medical expenses. In her restructured portfolio, equity has gone to about 25% of her total portfolio. Over the next 20 - 25 years there will be some inflation but keeping 25% of her portfolio should be enough.

Out of the increased income that she generates, I suggest an SIP into an index fund. This fund should protect her against inflation (apart from her equity funds and shares).

Many investors keep forgetting that a fall in the equity markets can cause a lot of pain in the debt market also (did somebody tell you to invest in debt to reduce risk?). A company hoping to repay a borrowing tranche by doing an IPO could suddenly default. So, in Poonam's case, I have shifted the funds into more dynamic bond funds, liquid funds, floater funds and one arbitrage fund.

I have also advised Poonam to slowly withdraw from equity if she ever has to dip into her capital. At her current levels of expenses, this portfolio should see her through if she lives to be 100 – providing for modest inflation.

I would also favor streamlining Poonam's portfolio. Pooja thinks she is an engaged investor and enjoys researching individual stocks. However, Pooja's ability to pick stocks in this difficult market seems to be over optimistic, based on a bull run and the fact that she does mental accounting!

For most children who oversee their parents' portfolios, however, simpler is usually better.

I would consolidate Poonam's equity holdings into a handful of high - conviction mutual funds. Not only would that move mean less administrative work for Pooja, who is also in charge of her own portfolio, but it also would result in greater diversification across sectors. This portfolio of Poonam's is also perhaps a little less emotional and going forward, a small portion of the

equity portfolio can be sold regularly and sale proceeds invested into dynamic bond funds.

Poonam's Portfolio after Repositioning:

Item of investments (Equity)	Market Value	Total	% age	Income
Reliance Industries	75000			
Coromandel Fertilisers	125000			
L & T	50000			
Eid Parry	50000			
EQUITIES		300,000	12.04	7000
Mutual Funds				
Equity	150000			
Franklin India Blue Chip	175000			
HDFC Top 200	175000			
Total MF Equities		325000	13.04	7000
Mutual Funds - Debt				
Templeton FMP	47000			
HDFC FMP	46000			
DSP Fmp				
39000				
Dynamic Bond fund	327000			
Total Debt 150,000		459000	18.42	33000
Post office	600000			
Banks	700000			
Cash	108500	1408500	56.50	140000
		2,492,500	1000.00	187000

Note: Names in the case studies have been changed to protect privacy.

CHAPTER 27

Miscellaneous-I

CHAPTER

Miscellaneous-I 27

The Gift that Keeps Giving
- Extra info for the inquisitive ones

There are some important topics which could not be fit into any specific chapter but were very important from a wealth creation point of view. A retirement plan is an important station in the journey of wealth creation, so here is a chapter which covers topics from change in strategy, national pension scheme, importance of account keeping, etc.

NPS : National Pension System

(NPS), a voluntary, defined contribution retirement savings scheme designed to enable individuals to save systematically during their earning life, was born in 1999. It was opened to the public only in 2009, and as of now has more than 1.2 crore subscribers and more than Rs. 1.5 Lakh crore under management. Most of this is compulsory, and its performance on the voluntary front is not so good, but it still has some traction as of now.

NPS suits those who are looking to save for their retirement but are not capable of creating a boutique of instruments which will take care of their retirement needs. If at all, it can be one of the products in your 'retirement bucket' and cannot be the ONLY retirement product that will help you retire well. Investing towards retirement not only requires proper asset allocation as one ages but also selecting the right schemes or products to invest in. Not everybody is in a position to cull out the right investment options on a regular basis over 25-30 years of working life. I am assuming that since you are reading this book you either know or are capable of learning how to invest for retirement. In short, this product is not for a smart investor.

There have been cases where the fund managers who took this money claimed to have charged you a low fee, but put it into other managed funds. This meant you paid a much HIGHER fee than what you were told. Not one but 3 fund managers did that. Then the law was amended, and now it cannot be done. There is always a risk that in a government owned and privately managed scheme there is no skin in the game – except your own!

For a 22-year-old joining NPS it is a product where he/she is going to invest for 38 years and get a pension for say another 30 years. So it is a 68 year investment product! It feels secure to know that the government runs a product which will not spring any surprise.

So you should be comfortable with this product, right? Well, no.

The Government has introduced a 'tax benefit' of extra Rs. 50,000 – which is a tax deferral scheme because when you withdraw the same it is taxable.

As the fund is being accumulated for retirement – it is obviously for a very long time. You can touch it only at your age of 60 – or maybe 70. However, this is not a fault, just a feature of the NPS.

If your short question is "should I invest in NPS" my answer is no.

Why am I saying this?

1. It is just a tax deferral scheme, not really a tax saving scheme like PPF or even ELSS
2. It is locked in for a very long time – which is unnecessary for disciplined investors like YOU
3. It does not have a 100% equity option, which means it suits only people above 50 not YOU!
4. A long-term investment product should be tax free, NPS is not.
5. For a long-term investment, it does not have Indexation and capital gains – this hurts.

6. Index Investing is safe, but returns could be lower.
7. Active investing without skin in the game is risky.
8. Annuity provides very poor and low returns
9. No choice of buying annuity on different dates

Reverse Mortgage

Let me start with a small personal experience.

One morning, I received an anguished cry of help from a 38-year-old, who called me from Canada saying, "My maternal uncle needs help. Will you please visit him at Colaba?"

The distress was genuine and I could not refuse. The uncle was a 63-year-old bachelor, who had lived life to the fullest and was now at the reefer end of his life. Literally, at 30 cigarettes a day, he really was at the reefer end. He needed medical, emotional and financial help. I could not really help him with the emotional and medical needs, but I could definitely peruse his financials!

He had a net worth of Rs. 25 lakh (Rs. 2.5 million) and a cash balance of Rs. 15,000. The net worth was a flat in Colaba. Apart from that, he had no shares, no fixed deposits, no National Savings Certificates and no insurance. His good fortune or rather the only assets he had were 3 nephews who were millionaires, staying abroad.

His condition was pitiable. He had no cash to last him for even one month, let alone money for food, medicines or a taxi to his sister's house. Although his sister, who lived in another part of Mumbai, constantly kept in touch, she had no idea of this state of affairs. The fault was entirely his, simply because he was not used to such a situation. He was a big-hearted, proud man who had helped people all his life. He had liberally given pocket money to his nephews, had helped his sister buy a house and paid for her daughter's wedding. It took him three months to tell me the full extent of his financial condition.

I blasted his nephew the first time I saw him. Not a great way to start a relationship, surely not as a client and a planner.

To come back to the story, I suggested that the rich nephews 'buy' the flat and take possession of the same at a later date — the doctors had anyway given him only about 36 months to live. I could not think of anything other than a reverse mortgage.

However, the story had a happy conclusion. The nephew felt rotten. He later told me he was too ashamed to see my face the instant he landed in Mumbai, so he called me two days later.

The nephew said his uncle would feel insecure and humiliated with a reverse mortgage. So, he asked for an alternative. I suggested a Rs. 10 lakh (Rs. 1 million) fixed deposit with a nationalized bank (where his uncle had a savings bank account) as an 'either or survivor' mode and the interest would be credited to his uncle's account. This would be to everyone's satisfaction. It could be done quietly and with no fan fare. Only 3 people knew about it — the bank manager was extremely helpful — and he offered to use his personal cash in an emergency after banking hours. The nephew was crushed by the help offered by the doctor, the banker and the neighbors.

The uncle withdrew from the savings account only twice. Soon after this arrangement, he died. But, he died a peaceful death, in his sleep and satisfied that his nephew had shown care to him with the requisite dignity.

More than 40 people attended his funeral — not one had any idea of his financial difficulty. The nephew realized money is not about how much you have. It is about how useful it is for people around you. How you make it go around. It is about how useful it is for people around you who are too proud to ask. It is for people whom you love, but are now on hard times. It is about helping without hurting feelings.

To come back to the purpose of this chapter, what was the reverse mortgage that I suggested to the nephew?

For most senior citizens and those nearing retirement today, the biggest fear is the need for money to live comfortably after retirement. In their era, the only investment they made was in their Provident Fund and of course, they bought their own home, which is an extremely illiquid asset, that doesn't generate cash if you're living in it.

Reverse mortgage can make the same home pay for your living expenses and that too, without having to move out of it.

I have structured three reverse mortgage deals for a few senior citizens and this is how it works. It is officially available now, but the rates are not very attractive. It is advisable to do it as a private arrangement between close friends or relatives.

Reverse mortgage:
A regular t (what we call a housing loan) is a forward mortgage, and hence it depends on the borrower's ability to earn and therefore repay the loan. A reverse mortgage on the other hand is a loan that looks only at the value of the asset, not at your current income at all. Reverse mortgage is a financial option that senior citizen homeowners can explore when they feel like they need it. Once all mortgages on their property have been paid off, they may borrow against the equity (or appreciation in value) of their home.

A reverse mortgage is a loan that enables homeowners to convert part of their value in their home into a tax-free income without having to sell their homes, give up the title, or take on a new monthly mortgage payment. Many homeowners can use this to supplement their retirement income, pay for their health care, modify their home or just get some cash for emergencies.

In a reverse mortgage, the owner of the home agrees to mortgage his home for a specific period of time or until his death. Against the mortgage, he receives either a lump sum or monthly payment or a combination of both.

On death, the home is transferred to the person paying the monthly amount or the legal heirs, depending on how the agreement is structured.

Let us look at one case where I structured a reverse mortgage. A retired person living in Bangalore was using a small portion of his lovely house. It was a nice 6-bedroom + 2 halls + 2 garages + 2 kitchens in a prime location.

The senior citizens — Mr. Srinivasan and his wife — were not keen on leaving the house and moving to a smaller house. Both their two sons were abroad and showed no signs of interest in this property worth at least Rs. 5 crore (Rs. 50 million).

Mr. Srinivasan had retired as an executive director of a PSU — about 20 years ago. He did not have a pension and his retirement corpus was evaporating. I structured a deal for him with his nephew who wanted to buy the bungalow.

The nephew has paid Rs. 1 crore (Rs. 5 million) into the Srinivasans' bank account. Apart from this, he will pay them Rs. 35,000 per month as rent for the rest of their lives. At the end of their lives, the house will go to the nephew. Ravi, the nephew, will pay all the statutory dues and upkeep, paint the house once in 3 years, maintain the garden and stay with them. His children now have 'grandparents' and he has a Rs. 5-crore house for Rs. 1 crore plus an annual rent of Rs. 1.8 lakh (Rs. 180,000). Mrs. Srinivasan is currently 67 years old. On an assumption that she lives until 80, the deal will be effective for the next 13 years.

Reverse mortgages can be structured for people by banks and mortgage companies — and not by individuals. By availing of it, the applicant would receive payment without being displaced from his current residence. Unlike ordinary home loans (mortgages), a reverse mortgage does not require repayment as long as the borrower lives in the home. Lenders recover their principal, plus interest, when the home is sold. The remaining value of the home goes to the homeowner or to his or her survivors. Payment may be

received in a lump sum, on a monthly basis (for a fixed term or for as long as they live in the home), or on an occasional basis as a line of credit.

Currently, **this product is ideal for a consumer who is asset-rich but liquidity-poor.** In fact, there is no competing product in the market.

The reverse mortgage can be used by senior homeowners (say age 65) and older to convert the equity in their home into monthly streams of income and/or a line of credit to be repaid when they no longer occupy the home.

- **Tenure:** Equal monthly payments as long as at least one borrower lives and continues to occupy the property as a principal residence
- **Term:** EMIs for a fixed period of months selected
- **Line of Credit:** Unscheduled payments or instalments at times, and in amount of borrower's choosing until the line of credit is exhausted
- **Modified Tenure:** Combination of line of credit with monthly payments for as long as the borrower remains in the home
- **Modified Term:** Combination of line of credit with monthly payments for a fixed period of months selected by the borrower

Current situation in India

The scheme is currently targeted at urban customers. All bankers (including a couple of foreign banks) agree that it is a very difficult product to take to the Indian market. The main worry is the social stigma attached to borrowing — an especially big issue in case of individuals aged 60 years and above. Also, a chat with a senior citizen reveals that he would use the monies from reverse mortgage for a medical emergency, but would not be comfortable using it for say a luxury like a holiday. Also, some children intimidate their parents — and emotionally stop them from creating a charge on their assets (stunning as it may sound!).

Eligibility and requirements

Individual

- Must be 60 years of age or older
- Must own your property
- Must occupy your property as primary residence

Property

- Single family home occupied by the borrower
- Not more than, say, a 17-year old building
- Clear, free title, with a no-objection certificate (NOC) from society

Currently there are two types of schemes available — the monthly payment scheme and the lump-sum scheme. The monthly scheme is the standard option. The lump-sum payment is conditional and is offered for medical treatment, loan prepayment etc.

The mortgage amount is based on:

- Age of the youngest borrower
- Current interest rate
- Lesser of appraised value or the internal upper limit

Financial

- No income or credit qualifications are required of the borrower
- No repayment as long as the property is the primary residence
- Closing costs may be financed in the mortgage

What you need to know

Reverse mortgage is ideal for someone who is 70 years and above, living in a property worth at least Rs. 30 lakh and above. For senior citizens less than 70 years of age, the loan amount will not be attractive enough to justify mortgaging their property. The older a borrower, the larger the percentage of the home's value that can be borrowed.

The hallmarks of a good reverse mortgage product are flexibility, availability and simplicity of use. It should also give an easy exit clause and be subject to the banking ombudsman's jurisdiction.

As a consumer, you should be aware of the eligibility — the property should not be more than 20 years old for availing reverse mortgage. It is better to avail of a joint liability scheme, though the amounts will be lower.

Valuation for the property is done by the lending institution and is the basis for payment. This may differ from the perceived value of the property.

What should you be aware of as a consumer? You ought to look at the systems of the bank and its capability to handle this product, which will be a little complex to start with.

There are no asset or income limitations on borrowers receiving reverse mortgages. The only condition is that this money should not be invested in a business.

The company assesses the value of the property and lends about 30% of the value to a customer in the age group of 60 years and about 60% to those of 80 years and above.

The major reverse mortgage lenders in India or banks and financial institutions providing reverse mortgage in India include:

- National Housing Bank
- Dewan Housing Finance Limited
- State Bank of India
- Punjab National Bank
- Indian Bank
- Central Bank of India
- Bank of Baroda

Options

One option that some senior citizens could consider is going to quality retirement homes, and selling/renting their property asset. However, this also involves going to a new place and creating a new infrastructure for yourself — from a grocer, a maid, a cook, a doctor, a bank to a CA to filing your IT returns. Many people find this intimidating.

These products are still evolving. But, it helps that the Central Government is keen on this, and that we have more than 30 years' experience of developed nations to guide us.

Senior Citizens Scam

The biggest threat today to the world of finance is scams. It is not sub-prime, it is not debt, nor is it terrorism. Scams are just any scheme aimed at getting you to part with your assets in return for nothing at all! Under such circumstances, if you are a senior citizen you are more inclined to be a victim.

Of course, immaterial of age, you are always a potential victim because of your greed or fear! And to a conman's eyes, senior citizens are easy prey. The perpetrators of these scams are great actors; they can appear likeable and trustworthy.

Scams and senior citizens

Police reports have shown that around a third of all fraud victims are senior citizens, so why are the elderly such an attractive proposition to the conman? It could be that senior citizens are more trusting or it could be that many live alone and are more susceptible to a smooth talking salesperson. Many seniors also have ready cash available and are no different to anyone else when it comes to a bargain.

Seniors may also have mental problems such as memory loss and confusion, which makes them an easy target for the conman. Politeness is a virtue that many conmen will prey on when using their high-pressure sales techniques; it is sometimes hard for seniors to say no when faced with a charming, friendly salesperson that seems to have their best interests at heart.

My parents are senior citizens and very sensible ones at that; but they are still vulnerable.

A simple example was a grocery delivery boy — who sent my father to fetch water — and made off with his mobile phone.

I have no doubt that if a thirsty person asks for water almost all the people I know will respond only way they know — go in to bring water! As a safety precaution, my parents now deal with only one shop with whom we have had a relationship for over 40 years.

Just say no to any purchase, any service, any charity or just anything offered by strangers. Did you not tell your daughter to stay away from strangers while going to school? Just do that for yourself.

The scams

Successfully avoiding scams means recognizing them when they happen, preferably before! Unfortunately, the list of swindles perpetrated on the public is endless, and new con tricks appear all the time. Watch out for a few key factors and remember one proverb when approached by anyone offering a bargain for very little money – "if it looks too good to be true, it probably is." Key factors that will help you to avoid losing your money:

The 13 Commandments

- **Resist high-pressure sales techniques**
- **Say no to strangers (remember you taught your kid to do that?)**
- **Always ask to think about the offer for a few days or put him off by saying that you need to consult with your children**
- **Say "I do not understand" — if he sounds irritated, avoid him**
- **If they say the offer is a 'once only, sign now' deal, avoid it**
- **Never pay with cash — no exceptions at all**
- **Conduct all transactions at the agency's office, except if it is a government agency**
- **Never fall for get rich quick schemes – they mean themselves, not you!**
- **Get a second/third opinion from a friend or family member**
- **Never, ever, give credit details over the phone**
- **Never, ever, give details on an unsecured, unknown website**

- **Avoid letters or calls that claim you have won a prize; these are rarely, if ever, legitimate**
- **Even Bill Gates gets spam mails saying that Microsoft is giving away prizes!**

E-scamming

Scamming has reached a new peak in terms of technology via the internet. Phishing is the term used for fraudulent emails designed to obtain details of either bank account numbers, credit cards or email passwords. These emails can look legitimate but by the time you realize that it is fake, your bank account has been cleared out and the conman has disappeared.

A reputed bank will never contact you by email asking for account details. Similarly, avoid emails claiming that you have won an international lottery. Also, avoid emails asking help to deposit funds in your bank account! These are scams designed to obtain your bank details

Telemarketing scams

"Sir you have just been selected to buy a timeshare at a great price — there is a 30% discount." This is a very attractive scam call. This will be followed by, "Please bring your cheque book, PAN card and 2 photos along." Remember, this is a sales call. The message is simple — you have not been 'selected' nor have you 'won' anything — instead, some conman is expertly pandering to your ego.

Just avoid such calls. Seek what you need to buy — there are no great deals going in the world everyday, and even if they were, they wouldn't be just a phone call away!

Other scams

It is impossible to list all of the scams that are perpetrated on a daily basis. Successfully avoiding the scams means that you take responsibility for your money and your own investments.

Voluntary Retirement Offer – Evaluation

For whatever reasons, voluntary retirement offers are now quite common and most people do not have a choice. However, if you do have a choice, see how to make the best of it. **If you are offered a voluntary retirement scheme (VRS) at age 45 and you have a transferable skill,** you could start a second career. If you join a small family-run business, you could even continue there until you are 65 or more — and thus it may actually be a good idea to take the VRS. Normally, VRS will have the following implications:

- Loss of salary: the most obvious implication is the loss of salary, so, there is no pay cheque
- Loss of group benefits: medical insurance, accident and life insurance, discounted housing interest rates (from an outside agency), etc.
- Loss of something worthwhile to do from 9 a.m. to 5 p.m.
- Loss of a social circle
- Loss of status at home as the 'bread earner'

If the company is going through a tough time and is making a VRS offer, it is better to take it without a fuss. In a tough competitive environment, the company may go out of business and have nothing to offer. So, taking the offer makes sense.

However, if the company has enough cash and is making a VRS offer, they are likely to offer half the salary for the next 10 years (basic with no allowances) and some other facilities. Here there is scope to negotiate — if not the money benefits such as insurance, accidental death benefit, some group buying discounts, etc. Most companies who offer a VRS to reduce the age group will bend and give way. **If you are enterprising, you can offer outsourcing some of the functions that you have been doing/overseeing. Opportunities such as vendor co-ordination, salary processing outsourcing, recruitment screening and recruitment background checking, are all functions that companies will happily outsource to retired employees with energy rather than outsource to**

outsiders. A few years ago, Tata Motors gave a free truck to its VRS employees as an incentive for taking the offer quickly — like an early bird offer. Thus, **being prepared for a VRS helps you take the early bird offer, which may be substantial.**

You need to evaluate a few factors before taking the offer:

- **Your income after VRS**
- **The chances of retaining some group insurance or a company paid medical coverage for life**
- **The chances of getting a similar job in a place of your choice**
- **Tax implications (some companies continue to pay a salary rather than a lump-sum)**
- **The company paying you or paying the fees to attend some skill building programs such as negotiation skills or computer skills**

Based on all this, you should take your decision to take the VRS. Normally, it is worth it. A friend who took a VRS showed me his bald plate and said, "Can you see the hair coming back? That is the fun of financial freedom — no boss to chew my brain!"

Accounting and tracking are just as important as doing!

In various articles on financial planning (and earlier in this book) you may have read that you must have SMART GOALS. The word SMART is an acronym which expands as follows:

S stands for Specific

M stands for Measurable

A stands for Actionable

R stands for Realistic and

T stands for Time.

Another way of saying SMART is to emphasize the importance of tracking. So **'T' stands for tracking.** If you have goals it is necessary for you to track whether you are on the correct path. If you were climbing a mountain and following a map, you would look for landmarks to ensure that you are on the correct path, will you not?

Record keeping is necessary (no, compulsory) for 3 main purposes:

1. **Tax returns filing**
2. **Investment performance tracking**
3. **Goals monitoring**

In exactly the same fashion if you are a serious player in the wealth creation business, we must be particular about the record keeping of your income, expenses, investments, taxation, etc.

All the 3 are critical and let us start in the same sequence as mentioned above.

You can avoid headaches at tax time by keeping track of your receipts and other records throughout the year. Good record-keeping will help you remember the various transactions you made during the year, which in turn may make filing your return a less taxing (pun intended!) experience.

Records help you document the deductions you've claimed on your return. You'll need this documentation should the IT department select your return for examination (officially called scrutiny). Normally, tax records should be kept for three years, but some documents — such as records relating to a home purchase or sale, share transactions, and business or rental property — should be kept longer.

In most cases, the IT department does not require you to keep records in any special manner. Generally speaking, however, you should keep any and all documents that may have an impact on your tax return:

- Bills
- Credit card and other receipts
- Invoices
- Mileage logs for those claiming reimbursement of car expenses from the employer Investment records – those which have helped you claim the deductions
- Cheque details or any other proof of payment
- Any other records to support deductions or credits you claim on your return.

Good record-keeping throughout the year saves you time and effort at tax time when organizing and completing your return. If you hire a paid professional to complete your return, the records you have kept will assist the preparer in quickly and accurately completing your return.

Nothing lasts forever, but you wouldn't believe it by looking at some people's record-keeping systems. People insist on keeping every scrap of paper, just in case. And when it comes to tax paperwork, folks are even more adamant. These documents will save me, they argue, if the IT department comes visiting.

The rule of thumb for tax papers is hold onto them until the chance of audit passes. Usually, this is three years after filing. But if the department suspects you underreported your income, it gets seven years to check into your tax life.

That's why most accountants advise taxpayers, even those who are meticulous filers, to keep tax documents for six to 10 years.

Some items, however, have a longer shelf life. These generally are assets that a taxpayer will eventually sell, triggering a tax bill. So if you have a pension plan, an endowment plan, own a home or invest in the share market, tax experts recommend keeping these records indefinitely.

> When it comes to tax-related documents, **you should keep those that help you identify sources of income, keep track of expenses, determine the value of property, prepare tax returns or support claims made on those returns.** However, common sense — as well as storage space — should be your guide.

For most taxpayers, **the biggest asset — and potential tax bill — is a home.**

While the rules for home sales have changed in recent years, meaning sale profits don't automatically face Capital Gains, any paperwork relating to a residence should be kept for as long as the home is owned. Inherited homes, homes broken down and reconstructed, etc. are all potential areas of tax confusion and should be taken care of.

Fast on the heels of home sales as tax triggers (and record-keeping headaches) are share transactions.

People who deal in equity shares need to keep track of all the proofs that the tax man can or will ask for. This means right issue offer letters, bonus letters, share buying and selling contracts etc. Keeping track of a FD or PPF wasn't that difficult, but when you move on to shares, the tax record

keeping becomes critical. If you are wondering why I am saying all this is simple – the new direct taxes code is bringing back the capital gains tax on equity shares.

Investment account statements contain financial data that a taxpayer will need as long as the share or mutual fund is owned. On the share side, there may be splits (bonus, rights, change in face value) that change the value of the holding and, therefore, the eventual worth of the share, which is used to determine the taxable cost.

Retirement record requirements

And then there are all those retirement savings plans, with all those different rules.

Contributions to PPF are tax free. But pension plans are tax-deferred. But sometimes already-taxed money goes into these accounts, too. All the annuities that you get are taxable.

Business considerations

If you operate a small business, from a moonlighting job to a small operation with several employees, dealing with records becomes a bit more complex.

The Income Tax generally focuses on self-employed travel and entertainment expenses, scrutinizing returns to make sure all the expenses are really related to the business and can be proven. In these cases, complete and accurate — but not overdone — contemporaneous records need to be kept until the audit threshold passes.

Unlike personal bank statements, business financial account records should be kept permanently. Similarly, anyone who has employees should hang onto employment information and related tax returns for as long as the business is running. And don't shred articles of incorporation, company bylaws, shareholder minutes, and trademark and copyright applications.

Pick a system, any system

Once you've identified critical records, the next step is to decide how to keep the data. Electronic bill paying can help keep track of your financial and tax life, but so can a plain old expense diary, as long as expenditures are entered faithfully. Do you need the computer and the world wide web to do it? Yes and a no. For repetitive, boring and accurate work the computer is a far better ally. The human mind it horrible in record keeping. Try calculating how much you spent on food in the past one month. Software programs (with faithful data entry work) can do a far, far better job.

It doesn't matter if it's a filing cabinet, cardboard boxes or a complex computer program. The key, is to find your record keeping comfort level, pick a system and stick with it.

Once you start down the path to investing, one thing that you'll notice is that the paperwork piles up fast. You'll get a confirmation every time you buy or sell a share or mutual fund, and every time you move money into or out of an account. And each of those account statements will probably include a couple of transactions, such as dividends you're received or interest that's been credited to your account.

If you invest using dividend reinvestment plans, or SIP (Systematic investment plans) you'll have another set of statements to deal with, for each DRIP and for each transaction. Every time you buy a mutual fund, you'll receive a statement in the mail. Shares you own will send you quarterly and annual reports and proxy statements.

The bottom line: You'll be swimming in paper if you don't get organized. Besides the advantage of keeping your desk or dining room table clutter-free, commercial software provides two some other important benefits:

Your CA will have all the up-to-date details in one location.

In case of you are physically (or mentally) disabled (or dead) the next person will find all the details in a well organized manner.

You'll be better equipped to know how much of your investing profits you'll owe to the tax, and can make better decisions regarding the tax

implications of any investment decision. Tax planning (which happens much before tax filing)

You'll be better equipped to figure out how well your portfolio has been performing and what problem areas you might need to address.

The biggest advantage of good record keeping to me comes from GOALS tracking. Most of us earn money to spend – on our selves, our families or charities. If this is so all the monies are earned towards meeting some goal. Goal tracking means checking whether your investments that you made towards a particular goal are going on track. Accounting software forward will help you set milestones and check whether the direction and speed of your investments are appropriate of whether it requires any change – in the direction or the speed. This to me is the biggest advantage of record keeping – it helps your Track your goals.

After all, Tracking is the last word in being SMART !

Changing strategies

From August of 2008 into 2009, as the financial crisis hit the global economy, many of our portfolios felt the tsunami. Like the Great Depression, some of us felt that the events we were witnessing would reshape our financial thinking and behavior for years to come. It was fair to think so.

How could it be otherwise? Pervasive, gut-wrenching fear was the theme. Friends and cousins all over the world were feeding us with horror stories. Fear about losing our jobs or even our homes, fear about not being able to retire well, or at all, fear about what would replace the tried-and-true strategies that had now failed to protect our hard-earned investments. We started questioning asset allocation strategies – asset classes all over the world just collapsed.

However, more than a year after the fall of Lehman Brothers, investors seemed to be breathing a bit easier all over the world. Stocks rebounded smartly, the U.S. economy appeared to have been pulled back. Unfortunately, governments all over the world pump primed the economy and have made all the economies look healthy.

It would be a mistake to see 2008's crisis as merely a one-time stumble in the world's economic cyclical paths. The international markets and economies are in the midst of a broader shift, and it is up to us to learn to recognize these seismic shifts and avoid repeating another painful loss to our retirement savings.

In the years from 2002 to 2007 (when Mr. Risk was on leave) we took all sets of data and came to fantastic conclusions. We concluded that when the dollar gets weak commodity will go up. We concluded that Asia was de-coupled from US. We concluded that a weak dollar will see strong commodities like oil – without worrying about high oil prices derailing Asian economies. We thought keeping money in debt was for sissies. After all men invested in equities.

We forgot that when returns are climaxing, risk is lurking pretty close. We assumed that equity returns of 30% p.a. is ours by right. We forgot 'Regression to the Mean'. We forgot that when standard deviation is high, arithmetic mean (arithmetic average) is a poor indicator regarding data reliability. If we had taken annual returns and seen the mean and median also we may have had better conclusion. Collectively we forgot 'Statistics 101'. It reminds me of a saying "When God wants you to have trouble, he takes away your brain". Well He did it for the whole world perhaps!

Have we learnt our lessons?
What exactly happened in 2008? **Well practically all investment categories moved in tandem with the S&P 500 Index. The index itself lost 37% in 2008—and everything else went down with it: the MSCI index of Europe, Asia and Australia tumbled 45%, the MSCI emerging markets index lost 55%, REITS gave up 37%, high-yield bonds lost 26% and commodities fell 37%.** Only people with a portfolio of just put options would have made money!

One important feature of every turmoil is – it is all right to lose money, but you cannot afford to lose the learning from it. To that end we have to see whether retirement investors have altered their views, assumptions and expectations about the markets. Also what effect the downturn may have had on their key retirement goals is very important to learn and remember.

For investors there are plenty of urgent lessons of the financial crisis – however they have not yet been etched in the memory. Too many investors are treating this as a temporary phenomenon that will not happen again. This crash course in all asset classes volatility notwithstanding, many individuals seem to be unrealistically relaxed about their existing strategies, as well as their ability to secure the retirement of their dreams. Maybe 2009 was more dangerous than 2008 – the journey from 21000 to 9000 and back to 17000 was quite fast. So the assumption for the common man was "a 60% fall will be followed by a 100% increase". The correct way to look at it is a 12,000 point follow was followed by a 8,000 point increase. Also the

market could have stayed lower and longer – and it can happen in 2024. We need to be prepared for all this turmoil.

Although investors (especially in equity dominated portfolios) lost an average of 40% of their portfolio values at the bottom, their retirement outlook is nonetheless overwhelmingly positive. In fact the recovery (quickly by any standards) make investors believe the situation will turn around (or has turned around) and they will one day have a great retirement. And most investors say they are at least somewhat confident that they will have the money they need when they want to retire.

This confidence is the belief by most of the investors that the world tsunami was only a temporary phenomenon and that things will eventually "go back to normal." I have no clue whether the world is out of the woods yet, or what the word normal will mean.

We are moving toward what looks like a very rough ride to a new economic world. From a borrowing nation most Asian countries are today lender nations. Is the world willing to let the US play a leading role in the world economy while keeping the biggest debtor nation tag for a few more decades? The emergence of China, India, Brazil, and others will be one of the big changes. It will change the way in which we need to think about investing going forward.

So what will the new normal look like? We can expect muted growth in the United States and in big parts of Europe even as their banks take on the task of finding out what risks they took. The sum total of their risk practices brought took them to Washington with begging bowls. That means less credit will be available for corporate expansion as well as consumption. Economies dependent on exporting to the developed nations will feel the heat for some more time to come. However this economic logic was short circuited by myopic governments all over the world – this will hurt in the longer run.

Inflationary pressures may increase in the US, as well as India. As world governments attempt to reduce the fiscal stimulus, putting the world

economic equations in place will be tough. The growing economies will find growing a challenge at a time that their currencies get stronger and stronger. A weak dollar could create another asset bubble in commodities.

The combined effect of governmental actions will be far-reaching. Equity values in the US will surely dip far more dramatically than what we have seen so far. Increasing correlations among all asset classes and world economies is almost a given.

In the new normal, our expectations for retirement investing need to see a shift as well. That means we may be able to rely less on traditional asset allocation models! Most people who have benefited from the asset build up in the 4-5 years ending 2007, still consider stocks to be the foundation of their retirement portfolios. Though this may be correct, and equities still underpinning so many retirement dreams, investors may need to face some painful choices in the future. Right from drastically scaling back a retirement lifestyle, delaying retirement or even never fully retiring at all may all be options.

Be ready for difficult and tough times

It will not be easy. If a man is a slave of his habits – changing habits is a huge challenge. And the same holds true for investing habits.

Investors who had seen their portfolios shrink in 2008 hold on to the conventional wisdom that, until recently, had seemed to work so well for them. Changing world economics will need change in life and investment strategies.

For financial planners it may be a good time to do some tough talking with clients. Surely these will be challenging conversations to clear their doubts, set realistic goals and reinforce the basic truths of good retirement planning. The message has to be clear - right-size your retirement expectations. Most investors I meet (helped by the shrill financial media) believe that the "world markets will bounce back and give back any losses" in their portfolios. They also have excessively robust return expectations for their portfolios. On an average so called 'educated' investors expect an average

annual rate of 15% p.a. over the long term. And to this end they are willing to keep all their moneys in equities. Assumption about jobs, increase in salaries are all taken as a sure fire repeat of their parent's life. This would be humorous if it was not such a serious subject.

Investors have to quickly learn how to bring down those expectations. Aiming at optimum returns instead of maximum returns should be a good start. As a beginning estimate retirement needs smartly and keep reviewing it on the basis of observations and dialogues with senior friends and relatives. This done, then invest big portions of these assets protecting it from irrecoverable losses. The good news is that this process leaves investors free to take well-reasoned risks with other parts of their portfolios.

Save and invest more. Many investors say that they want to save (and invest) more, but most people have not made that change! Convincing tsunami hit investors to do more SIPs is difficult, but critical to their success, nay survival as a retired couple! **The reasons for investing more is two fold – one is to make up for the loss in the portfolios, and second to be prepared for a lower equity return over the next few years.** Innovative ways to motivate investors to invest more has to be a top government priority.

Asset allocation has to look beyond pure paper assets – while worrying about the next asset bubble build up. Many investors were over-exposed to stocks (circa Sensex 21000 pre melt down) now they need to resist the urge to dramatically change their asset allocation to make up for lost time! In the compounding formula it is like trying to increase 'r' (rate of return) to compensate for the time (n) available. It is not only difficult, it is impossible. While equities clearly have a place in a retirement portfolio, traditional strategies-viewed by most of us as the model allocation-may no longer be effective in this environment. Inflation protecting assets like Inflation adjusted bonds, commodities, metals, should be considered in retiree portfolios also.

Most importantly hedge against inflation. Most investors 'think' they factor inflation into their retirement planning, but may not even know what rate of

inflation to factor in. Most investors use stocks as an inflation hedge, but over the past 10-12 years stocks have done badly in the developed economies. And a decade is not exactly a short period of time. If it is the first decade post retirement, your patience will be tested.

For many investors, health- care costs are the great unknown of retirement planning; two-thirds say that covering healthcare costs will be a "must have" in their retirement, yet nearly just as many of them have not accounted for health care costs in their spending needs. In fact, many say they expect to enjoy "better-than-average" health throughout retirement. A more realistic strategy is planning for this critical cost factor and investing prudently to get there.

A reassuring hand

The good news is that smarter investors are willing to seek guidance on topics such as tactical asset allocation, generating income in retirement, re-allocation of assets, drawdown more conservatively, invest more, etc. ensuring that they do not outlive their assets in retirement and providing for uninsurable medical care in the older age.

Many financial advisors have had increased interaction with their investors since the financial crisis began. More realistic retirement goals are being set and many are also having very useful and blunt discussions about lowering investors' expected returns as well as the need for contributing more towards retirement plans and staying committed.

What are the key take away for investors, especially those who are planning for retirement (which is why I presume you are reading this book!)

It may not sound very great at a cocktail party but you are generally well off over a long period of time in a cheap index fund. All those people who invested in Madoff's schemes were chasing 'returns superior to the overall markets' and lost their whole capital. **Never invest in something which you do not understand.** Very poor risk reward ratio.

When an emergency occurs you need cash. **Emergency can be of 2 types – one when you need cash and your assets are illiquid.** So if your assets are frozen you cannot access the 'cash' available in the asset.

Your risk taking ability is not just a function of your age – it is also decided by how great a qualification and how good a job you have. A well qualified and honest person working in a government job is far better off than a commissioned salesman.

Most relationship managers earn money if there is activity in your portfolio. **You earn money if there is growth in your portfolio.** This is an unfortunate conflict in advising and selling – understand this and then operate with this in your line of vision.

> **Financial literacy is far less expensive: If you think financial literacy is expensive, try financial illiteracy! Not knowing what you are doing will hurt – the strategy which made you look good from 2002 to 2007 would have made you look very bad in 2008. Changing external environment calls for a changing strategy.**

The big firms are as bad at predicting as your street side astrologer. The biggest wealth management companies went to Washington with their begging bowls. Indian regulators and fund managers had done a far greater job. Do not get carried away by labels.

This may be a little late advice, but when you lose 30% of your equity portfolio, it is time to invest more, not bolt after the horse has run away. So hit the markets hard by increasing your SIPs. By the way the SIP which was started when the index was at 21000 is already making profits and is in the black. So reiterating what you know - **SIP works.**

50 billion flies eat shit. It does not mean…you know what I mean do you not? Do not seek safety in numbers. Normally at the peak of a mania there are more people in the game. Sir Issac Newton lost money in one of the manias!

Asset bubbles get built up when everybody is willing to give you a credit card with a very nice upper limit. Be aware of the fact that normally loans have to be repaid. If you are not sure about your qualification, job or company, downsize, do not take an extra credit card to roll your money.

For the media 'has not happened in the last 3 years' and 'impossible' mean the same thing. Wear ear plugs when the box is on. Even better watch animal planet.

Asset allocation is difficult to understand. In 2008 equities, debt and commodities all fell. So if you had Hindalco shares, Jindal steel debentures and call options on copper – you were not diversified at all. When metals fell, your portfolio developed flu leading to pneumonia.

Expect to get about 12% to 13% return in your equity portfolio. In a year in which you get 90% it is always nice to remove some money to repay your home loan or invest in debt securities.

Do not abdicate if you cannot understand. We regularly see family members cheat other family members. Learn about your investments, sign all papers yourself, if you do not understand stay away.

Take all expert predictions with a pinch of salt. If a fund manager says 'the market is fairly priced' it might mean "hey dude I think the market is over the top, if you take your money out, my bonus will go down' – so learn to read between the lines. If all experts agree, simply panic. If not very sure about you positions, cut your positions by half.

Predicting short term market movement is a media pass time, let them indulge. For long term wealth creation SIP in a good portfolio is still the key. Still trying to predict the next short-term move, or call the market bottom? Sure, I got bottom calls from 20,000 to at every fall of 500 points right down to 6500. Unfortunately picking 9000 out of that numeric soup was not easy! When you make a lot of predictions one of them will turn out to be right. How do I know which one?

I cannot agree more with Warren Buffet when he says “Risk comes from doing something that you do not understand”.

Defined benefits and Defined contribution

There are certain words without which a book on Retirement Planning cannot be complete. These words are **'Defined Benefits'** and **'Defined Contribution'.** Let us see what these words mean:

There are largely two major ways in which retirement benefits from an employer are received. The nature of the benefits will also impact the way in which the planning process is conducted. Both methods are different and have to be understood.

Defined benefits

The name is clear as to what this does is it not? **Defined benefit plans are those where the benefit provided to an individual after retirement is known.** This means that the route for calculating the benefit is clearly defined at the starting point itself. A retiree becomes eligible for the benefit will be able to make the calculations and arrive at the figure. For example if you complete 20 years of service with the Central Government you are entitled to a pension of 50% of your last drawn salary (only the basic salary) and you also get 27% of this amount as a dearness allowance. This amount is indexed so if you do live long your pension is likely to be much higher than the last drawn salary. On death of the pensioner his wife will get 30% of his last drawn salary for the rest of her life.

These plans are beneficial because the amount to be received can be calculated very easily and there is no ambiguity about the amount. If you are a government employee the pension also goes up every time there is a pay commission suggestion implemented. The responsibility for ensuring funds availability shifts from the 'employee' to the 'employer'. This is fantastic from the employee's point of view, but puts enormous burden on the employer. Such plans are currently found only with older government employees – the newer employees have to look towards the National Pension Scheme.

Employers know that employees like such a pension plan so they put a lot of conditions. For example only people who complete 15 years service may be eligible for a pension. It may be capped at a particular level of indexing and not indexed indefinitely. However the full fund management responsibility lies with the employer – and shareholders of the companies do not like it, because the liability is open ended. If all employees start living long it can even bankrupt companies. Companies like General Motors and IBM have suffered from Defined Benefits Pension plans that they have for their employees.

The existence of the Payment of Gratuity Act means that the payment of gratuity is a legal duty in most organisations. This liability happens when the employee completes five years with one employer. Here, the payment is usually made as a certain month's contribution for each completed year to the employee.

> One example of this is **the payment of gratuity. 'Leave' salary and the employees pension scheme are other examples of a defined benefit plan.**

The defined benefit schemes have been present for a long period of time and for all government employees and many other seniors in the corporate hierarchy, this has been the bread provider.

The problem was that over a period of time the system has became unsustainable as the number of people who retired is far greater than those in employment.

Defined contribution

Defined contribution is the more important retirement benefit method. The features of this route are different from what the defined benefit method seeks to give. **Here the employee opens a provident fund account and the employer contributes his share to the fund. The fund is then managed either by the Central Government scheme or a company**

creates its own trust. At the end of an employee's working life this accumulation is handed over to the employee who has to create his own annuity.

There are differences in both the above methods of retirement benefits drawing. In case of the Defined benefit the market risk and fund performance risk is with the annuity provider. If he falls short he dips into his current revenues and pays the pension.

There are some companies in the private sector which have a hybrid system. They pay a defined benefit pension based on a formula – but subject to a cap and without indexing. However, they cover their senior employees for medical expenses with an upper limit of say Rs. 300,000.

Routes to achieving retirement goals

There is a need to use either route to reach the retirement goal. There is a need to effectively balance the various routes in such a way that the overall goals of the individual with regard to their retirement are achieved.

CHAPTER 28

Miscellaneous II

CHAPTER

Retirement Calculators 28

The gift that keeps giving:
Cheat codes for the lazy folks

How much should I save for retirement?

No single formula can answer this question. And any answer is open to interpretation simply because the assumptions that you make can make a lot of difference. At best, you can estimate how much you will need for your retirement.

"Common sense is calculation applied to life"
- Henri Frederic Amiel

Here is another attempt at trying to answer this question. Obviously, how much to accumulate for retirement is a function of your current standard of living, how much time you have to retire, how long you expect to live and how well your investments grow.

Or better still, let me illustrate this with an example.
If you are a 30-year-old and spending Rs. 10,000 a month, you need to invest Rs. 7000 a month. However, you may find it difficult or impossible to invest Rs. 7000 a month and you are able to invest only Rs. 4000 a month. Now this shortfall is Rs. 3000.

The action that you can take is REDUCE your expenses to say Rs. 9000 a month - this will reduce your requirement to Rs. 6300 - and you will be able

to invest Rs. 5000 a month. Thus, the gap falls to Rs. 1300 a month – a huge difference from the earlier figure!

So, use this calculator to choose your current life style - and realise that you can choose both the numbers! If you spend Rs. 10,000 a month and invest only Rs. 4000 a month, please remember you will have to compromise on your put together post retirement!

Assumptions

- Inflation will be at 8% per annum - in all the calculations
- Investment will grow at 12% per annum till you reach the age of 60
- Retirement will be at age 60 years
- You will live till 85
- Current investment for retirement is nil
- Post retirement corpus will grow at 10% per annum
- The monthly investing will be in an equity fund or a balanced fund depending on your age
- Corpus will be made nil at the age of 85.

Retirement Calculator

Current age	Time to retirement	Current expenses	Expenses at retirement*	Corpus required	Monthly amount to save	Amount per day that you have to save
25	35	5,000	73,927	17,000,000	2,700	90
25	35	10,000	147,853	34,000,000	5,400	180
25	35	25,000	369,634	85,000,000	13,500	450
25	35	50,000	739,267	170,000,000	27,000	900
25	35	100,000	1,478,534	340,000,000	54,000	1800
30	30	5,000	50,313	12,000,000	3,500	117
30	30	10,000	100,627	24,000,000	7,000	233
30	30	25,000	251,566	60,000,000	17,500	583
30	30	50,000	503,133	120,000,000	35,000	1167
30	30	100,000	1,006,266	240,000,000	70,000	2333
35	25	5,000	34,242	7,800,000	4,250	142
35	25	10,000	68,485	15,600,000	8,500	283
35	25	25,000	171,212	39,000,000	21,250	708
35	25	50,000	342,424	78,000,000	42,500	1417
35	25	100,000	684,848	156,000,000	85,000	2833
40	20	5,000	23,305	5,350,000	5,450	182
40	20	10,000	46,610	10,700,000	10,900	363
40	20	25,000	116,524	26,750,000	27,250	908
40	20	50,000	233,048	53,500,000	54,500	1817
40	20	100,000	466,096	107,000,000	109,000	3633
45	15	5,000	15,861	3,700,000	7,500	250
45	15	10,000	31,722	7,400,000	15,000	500
45	15	25,000	79,304	18,500,000	37,500	1250
45	15	50,000	158,608	37,000,000	75,000	2500
45	15	100,000	317,217	74,000,000	150,000	5000

Let me give you some more simple calculators to understand how your money grows and how you can make it work for you.

One-time Investment Calculator

This calculator allows you to understand how much your money will grow to if you invest a one-time lump sum. If you invest 15000 for 20 years and you expect to earn at the rate of 15% per annum (continuous compounding, no tax at least till you withdraw) you will have Rs. 163,665 * 1.5 which is equal to Rs. 245,498.

For purposes of calculation, we have not considered whether the amount is paid at the beginning of the period or at the end of the period. Also, the compounding is assumed to be on an annual basis.

One-time Investment Calculator

No. of years of investment	Rate				
	3.50%	6%	10%	15%	18%
10	14,106	17,908	25,937	40,456	52,338
15	16,753	23,966	41,772	81,371	119,737
20	19,898	32,071	67,275	163,665	273,930
25	23,632	42,919	108,347	329,190	626,686
30	28,068	57,435	174,494	662,118	1,433,706
35	33,336	76,861	281,024	1,331,755	3,279,973
40	39,593	102,857	452,593	452,593	7,503,783
45	47,024	137,646	728,905	728,905	17,166,839
50	55,849	184,202	1,173,909	1,173,909	39,273,569

How this calculator helps you

If you buy a single premium pension plan and you wish to know how much the money will grow to you can use this table. If you invest Rs. 100,000 when you are 30 years and you think the money will grow at 10% per annum compounded how much will you have at your retirement age of 60 years?

Well, you will have Rs. 17,44,494 !

However, quite often you will not have a large amount at hand to invest as a lump sum. In such cases you should use the following calculator — the SIP calculator.

SIP Calculator

This calculator tells you how much your money will grow if you were to contribute a regular amount to a mutual fund or a bank recurring deposit. However, in case of a unit linked plan or a mutual fund you pay tax (if at all) only when you withdraw at the end of the plan.

Again, like all calculators it ignores taxation - it is assumed that the product allows you the benefits of compounding without any leak like taxation in between.

Assumption: The amount of investment is about Rs. 10,000 a month

SIP Calculator

No. of years of investment	Rate				
	3.50%	6%	10%	15%	18%
10	143,433	163,879	204,845	275,217	331,288
15	236,286	180,000	414,470	180,000	180,000
20	346,869	462,041	759,369	1,497,239	2,308,854
25	478,568	692,994	1,326,833	3,243,530	5,737,253
30	635,413	1,004,515	2,260,488	6,923,280	14,113,585
35	822,206	1,424,710	3,796,638	14,677,180	34,578,806
40	1,044,667	1,991,491	6,324,080	31,016,055	84,579,836
45	1,309,605	2,755,993	10,482,502	65,445,027	206,743,343
50	1,625,130	3,787,191	17,324,391	137,993,114	505,215,639

If you did a SIP of Rs. 1000 a month from your age of 30, how much money would you have at your age of 60? Assume the money will grow at 15% per annum.

The answer is Rs. 69,23,280! There is a fantastic reward for patience! Your contribution for 30 years is Rs. 36,00,000 - the balance is growth!

Future Expenses Calculator

This calculator tells you how much your expenses after a particular will be period of time. It is convenient for us to assume that inflation will be a flat number. It is rarely so. Vegetables and staples may increase by 8% per annum but college fees could go up by 15%.

Assumptions:

- Inflation will be at 5% - as we go towards being a developed economy, we can hope to be hit by a lower inflation number
- Current expenses are Rs. 1,00,000

Future Expenses Calculator

Number of years of expenditure	Expenses
1	105,000
5	127,628
10	162,889
15	207,893
20	265,330
25	338,635
30	432,194
35	551,602

Even at modest inflation, you see your expenses double in 15 years. If the inflation figure was, say 8%, your expenses could double in 9 years. This table shows you the risk of ignoring inflation — over long periods of time it can hurt your retirement plans.

Millionaire Calculator

Becoming a millionaire at 35 is easy! But what will a million buy after 35 years?

Without adjusting for inflation, the word ‘millionaire’ always has an aura about itself! This calculator tells you in how many years you can become a millionaire. It also tells you how much you would have to invest every month to become a millionaire if you were to leave your money in a savings bank account.

Investment Target Calculator - Target amount Rs. 10 lakhs

No. of years of investment	Rate			
	3.50%	9%	15%	18%
1	82000	79950	77760	76700
5	15270	13260	11290	10394
10	6970	5170	3630	3019
15	4230	2640	1500	1105
20	2880	1500	670	434
25	2090	890	310	175
30	1570	550	140	71
35	1220	340	70	29

Effect of Inflation Calculator

This calculator tells you how far your money will go. For example, at the end of one year, you will pay Rs. 1050 for something that you are paying Rs. 1000 today.

Similarly, if inflation in the past one year has been 5%, your income should go up to at least Rs. 1050 for every Rs. 1000 that you were earning. Thus, if your monthly income in June 2017 was Rs. 100,000, it should be Rs. 105,000 in June 2018 to match inflation.

Inflation Effect Calculator

Number of Years	If I have Rs. 1000, today it will be able to buy goods worth Rs.	I will need this amount to afford the same product/service
1	950	1050
5	774	1276

10	599	1629
15	463	2079
20	358	2653

Assuming modest inflation, you realise that in 15 years the buying power of your money has fallen by half. If you assume a higher level of inflation, it may take a lesser amount of time for your expenses to double. Obviously, for calculation purposes we assume a flat rate of inflation. Real life is different! The figures may change from year to year or person to person.

Cost of Delay Calculator

This calculator tells you the amount that you could lose because of deferring your investment decision by one year. Put simply, you lose out on the effects of compounding.

Assumptions

- Your retirement age is 60 years
- Interest rate is at 9% per annum

Cost of Delay Calculator

Age	@ Monthly investment of Rs. 1000, amount lost until age 60	@ Monthly investment of Rs. 1500, amount lost until age 60
18	4,12,910	6,19,635
22	2,88,470	4,32,705
25	2,20,440	3,30,660
30	1,40,790	2,11,185

If you are planning to invest Rs. 1,500 a month, do it now! This calculator shows you how the 18-year-old person's investment corpus has been hurt because of the lesser time the money spends compounding. The loss for the 18-year-old is 42 years of compounding! For the 30-year-old, it is only 30 years.

Retirement Corpus Calculator

If you were to save Rs. 1500 per month what would be the corpus of your saving at age 60 years? Depends on when you start! If you started saving at age 18 years, you would have Rs. 7,021,980 but if you start at 50 you will have only Rs. 2,90,271.

Assumption

- Your money will grow at 9% per annum Retirement Corpus Calculator

Age of Starting Investment	Retirement Corpus
18	7,021,980
22	4,845,378
30	2,262,456
36	1,520,306
40	1,001,830
50	290,271

I hope these calculators help you in your mission for saving / investing for your retirement. Use these calculators to plan your investments and expenditure for today, and enjoy a comfortable retirement!

CHAPTER 29

Glossary

CHAPTER 29
Glossary

Accidental Death Insurance
Insurance that provides coverage in the event of death due to accidental injuries, but not illness.

Actuary
A person professionally trained in the technical aspects of pensions, insurance and related fields.

Adjuster
(a) A person who investigates and settles losses for an insurance carrier.
(b) Individual employed by a general insurance company to settle claims brought by insured.

Administrator
An individual or professional organization, such as a bank, appointed by the court to administer an estate when the owner dies without having made a will or without nominating an executor.

Agent
A licensed insurance company representative, who solicits, negotiates or effects contracts of insurance, and provides services to the policyholder for the insurer.

All-risks Policy
Coverage by an insurance contract that promises to cover all losses except those losses specifically excluded in the policy.

Annuity

An annuity is an investment, which you make either in a lump sum or through installments paid over a certain number of years. In return, you receive a specific sum every year, every half-year or every month, either for life or for a fixed number of years.

Assignment
The legal transfer of one person's interest in an insurance policy to another person.

Accrual Basis
The income earned or expense incurred that is accounted for even though the cash may not have been received or paid yet.

Amortization
The process of fully writing off indebtedness by installments of principal over a definite time.

Advisor
Person or firm hired or employed by a mutual fund or individuals to manage assets or give financial advice.

Asset Allocation
Investing by distributing money among different kind of assets such as mutual funds, commodities, unit linked plans, shares, bonds, real estate and cash.

At Par
A fund or a share selling at a price equal to its face value.

Average Annual Yield
Sum of each year's return on investment and divided by the number of years invested.

AAA
The highest rating given by a bond-rating agency. May change on the rating agency-specific nomenclature.

Annuitant
The person during whose life an annuity is payable.

Application
A signed statement of facts made by a person applying for life insurance and then used by the insurance company to decide whether or not to issue a policy. The application becomes part of the insurance contract when the policy is issued.

Assignment
The legal transfer on one person's interest in an insurance policy to another person or entity, such as to a bank to qualify for a loan.

Adjustable Life
A form of life insurance that allows changes on the sum assured, the amount of premium, period of protection, and the length of the premium payment period.

Adjustable Premium
The right of an insurer to change the premium rate on classes of the insured, or blocks of business at the time of policy renewal.

Assets
The resources, or properties and property rights, owned by an individual or business enterprise.

A bond
A debt obligation backed by the integrity or general credit of the issuing borrower (called unsecured) or secured by a lien on any specific asset (called secured).

Balanced Fund
A mutual fund scheme that invests half its corpus in equity and the other half in debt instruments.

Bear

An investor who believes that a security is about to fall, and thus sells shares.

Bull
An investor who believes that a security is about to rise, and thus buys shares.

Blue Chip
A very high quality share.

Bond
A debt instrument issued for a period of more than one year with the purpose of raising capital by borrowing. The term is interchangeably used for debentures.

Brokerage
The commission payable to a broker for the transaction he carries on your behalf.

Beneficiary
An individual designated in a will to receive an inheritance, or the individual designated to receive the proceeds of an insurance policy, retirement account, trust, or other asset.

Backdating
A procedure for making the effective date of a policy earlier than the application date. Backdating is often used to make the age of the consumer at policy issue lower than it actually was to get a lower premium.

Bank Credit
The borrowing capacity provided to an individual by the banking system, in the form of an overdraft, a credit card or a loan. The total bank credit the individual has is the sum of the borrowing capacity each lender bank provides to the individual.

Collateral

Assets, such as a house or shares and bonds, pledged to support a loan. This 'guarantees' that you that you will pay back the loan according to its terms, failing which the assets will be sold off.

Current Assets
Cash or other items that will normally be turned into cash within 1 year, and assets that will be used up in the operations of a firm within 1 year

Current Liabilities
Amounts owed that will normally be paid off within 1 year. Such items include accounts payable, wages payable, taxes payable, the current portion of a long-term debt and dividends payable.

Captive Agent
One who sells insurance for only one company as opposed to an agent who represents several companies. Currently, all agents in India are captive agents.

Children's Policies
Children's insurance policies include those through which parents or legal guardians can provide for life insurance for their child.

Cumulative Bonus
The percentage at which the sum insured is increased annually, without additional premium, e.g. Personal Accident Insurance, Medical Insurance.

Claim
A request for payment of a loss that may come under the terms of an insurance contract.

Commission
The part of an insurance premium paid by the insurer to an agent or broker for his services in procuring and servicing the insurance.

Contribution
The principle of insurance by which the insured is prevented from recovering more than his loss, despite his having several insurance policies.

Capital Gains
The profit earned on selling capital assets.

Certificate of Deposit – an American Term for Fixed Deposit
Short or medium term, interest bearing, debt instrument offered by banks

Capital Market
A place where long-term securities are sold or bought. The stock exchange is an important part of the capital market.

Clubbing Provision
Legislation under which interest, dividends, or capital gains earned on assets that you transfer to your spouse will be treated as your own for tax purposes. Interest or dividends relating to property transferred to children under 18 also will be attributed to you.

Cash Surrender Value
This is the amount available to the owner of a life insurance policy on voluntary termination of the policy before it becomes payable by the death of the life insured. This does not apply to term insurance but only to those policies that have reduced paid-up and cash surrender values. A cash surrender in lieu of death benefit usually has tax implications.

Co-insurance
In medical insurance, the insured person and the insurer sometimes share the cost of services under a policy in a specified ratio: for example, 80% by the insurer and 20% by the insured. Thus, the cost of coverage to the insured is reduced.

Compound Interest
Interest earned on an investment at periodic intervals and added to principal and previous interest earned. Each time new interest earned is calculated, it is on a combined total of principal and previous interest earned. Essentially, interest is paid on top of interest.

Credit Card

Any card that may be used repeatedly to borrow money or buy products and services on credit.

Contributory
A general term used to describe a plan of employee coverage in which the employee pays at least part of the premium.

Down Payment
The amount of money to be paid by the purchaser to the seller on the signing of the agreement of sale.

Declination
The insurer's refusal to insure an individual after careful evaluation of the application for insurance and any other pertinent factors.

Dependent
An individual who depends on another for support and maintenance.

Double Insurance
If the insurance policy is taken from more than one underwriter where the period of insurance, subject matter of insurance and sum insured are same, then this is called double insurance.

Death Benefit
The amount stated in a policy contract as payable on the death of the person whose life is being insured.

Deferred Premium
The unpaid and yet undue premiums on Life Insurance, paid on other than an annual premium basis.

Deferred Annuity
An annuity providing for income payments to commence at a specified future time.

Disability Insurance

Insurance that pays you an ongoing income if you become disabled and are unable to pursue employment or business activities. There are limits to how much you can receive based on your pre-disability earnings. Rates will vary based on occupational duties and length of time in a particular industry. This kind of coverage has a waiting period before you can begin collecting benefits.

Diversification
Investing such that not all your eggs are in the same basket. By spreading your investments over different kinds of investments, you cushion your portfolio from sudden swings in any one area.

Dividend
As the term dividend relates to a company's earnings, a dividend is an amount paid per share from a company's after-tax profits. Depending on the type of share, it may or may not have the right to earn any dividends and corporations may reduce or even suspend dividend payments if they are not doing well.

Bonus in a Life Insurance Policy (or Dividend)
As the term dividend relates to a life insurance policy, it means that if that policy is 'participating,' the policy owner is entitled to participate in an equitable distribution of the surplus earnings of the insurance company that issued the policy. Surpluses arise primarily from three sources:

(1) The difference between anticipated and actual operating expenses
(2) The difference between anticipated and actual claims experience
(3) Income earned on investments over and above the rate required to maintain policy reserves

With regard to the source of the surplus, the 'dividend' so paid can be considered, in part at least, as a refund of part of the premium paid by the policy owner.

Diversification
Investing in different companies and sectors to spread risk.

Deep Discount Bond
A long-term debt instrument selling at a high discount of its face value.

Dividend Warrant
Cheque issued by a company to its shareholder.

Debit Card
A card that allows customers to access their funds immediately, electronically – used in shops and establishment to make immediate payments.

Draft
An instrument signed by a drawer to a drawee requesting payment at a future time to a third party (often the drawer).

Endowment Policy
An endowment policy covers risk for a specified period, at the end of which the sum assured is paid back to the policyholder, along with the bonus accumulated during the term of the policy.

Earnest Money
The deposit money given to the seller or his agent by the potential buyer on the signing of the agreement of sale to show that he is serious about buying the house. If the sale goes through, the earnest money is adjusted against the down payment.

Effective Annual Interest Rate
The actual annual interest rate that accrues, after taking into consideration the effects of compounding (when compounding occurs more than once per year).

Equity
Equity is the owners' investment in the business. Unlike capital, equity is what remains after the liabilities of the company are subtracted from the assets.

Financial Statement

A report that shows the financial condition of a business for a specified period (such as one year).

Fixed Assets
Those items of a permanent nature, required for the normal running of a business, and not converted into cash during a normal fiscal period. Examples include building, machinery, and furniture.

Fixed (Long-Term) Liabilities
Liabilities that will not mature during the next accounting period.

Foreign Exchange Rate
Rate at which one currency can be converted into another currency.

Fund Manager
A person who manages a mutual fund.

Futures Options
An option on a futures contract.

Forward Market
A market in which participants agree to trade some commodity, security, or foreign exchange at a fixed price for future delivery.

Floaters
Insurance policies that cover property / members of a group that can be moved from one location to another for both transportation perils and perils affecting property at a fixed location. Medical insurance too is now available as floaters.

Gilts
Securities issued by the government. As the name signifies, the security is safe and as sound as gold itself.

Grace Period
A specific time after a premium payment is due during which the policy owner may make a payment, and during which, the protection of the policy

continues. The grace period usually ends in 30 days.

Group Life Insurance
A common form of life insurance found in employee benefit plans and bank mortgage insurance. In employee benefit plans, the form of this insurance is usually one-year renewable term insurance. The cost of this coverage is based on the average age of everyone in the group. Therefore, a group of young people would have inexpensive rates and an older group would have rates that are more expensive.

Some people rely on this kind of insurance as their primary coverage forgetting that group life insurance is a condition of employment with their employer. The coverage is not portable and cannot be taken with you if you change jobs. If you have a change in health, you may not qualify for new coverage at your new place of employment.

Bank mortgage insurance is also usually group insurance: you only receive a certificate of insurance, and not a complete policy. The only form in which bank mortgage insurance is sold is reducing term insurance, matching the declining mortgage balance. The only beneficiary that can be chosen for this kind of insurance is the bank. In both cases, employee benefit plan group insurance and bank mortgage insurance, the coverage is not guaranteed. This means that coverage can be cancelled by the insurance company underwriting that particular plan, if they encounter excessive claims.

Hedging
A strategy designed to reduce investment risk.

Hedge Fund
A fund that may employ a variety of techniques to enhance returns. In a bull market, they may be long, in a bear market they may be short; they are also allowed to borrow to enhance returns.

Holding Period
Length of time that an individual holds a security.

Indemnification
Compensation to the victim of a loss, in whole or in part, by payment, repair, or replacement.

Insurance

(1) A system under which individuals, businesses, and other organizations or entities, in exchange for payment of a sum of money (a premium), are guaranteed compensation for losses resulting from certain perils under specified conditions

(2) Protection by written contract against the financial hazards (in whole or in part) of the happenings of specified fortuitous events

Incontestable Clause – Called Early Claim in India
A clause in regular life insurance policy that provides for voiding the contract of insurance for up to two years from the date of issue of the coverage. This is if the life insured has failed to disclose important information or if there has been a misrepresentation of a material fact that would have prevented the coverage from being issued in the first place. After the end of two years from issue, a misrepresentation of smoking habits or age can still void or change the policy.

Income Splitting
A tax planning strategy of arranging for income to be transferred to family members who are in lower tax brackets than the one earning the income to reduce taxes.

Independent Broker
An independent businessperson who usually represents more than one life or general insurance companies in a sales and service capacity and who is paid a commission by those insurance companies for sales and service of insurance products.

Insurable Interest
The law provides that a person have an unlimited insurable interest in his own life. It is still a legal stipulation that an insurance contract is not valid unless insurable interest exists at the time the policy is issued. However, life

insurance companies will not issue unlimited amounts of coverage to an individual. The amount of life insurance which will be approved has to approximate the loss caused by the death of the individual and must not result in a windfall for the beneficiary.

Inflation
The rate at which the general level of prices for goods and services is rising.

Initial Public Offering (IPO)
A company's first sale of shares to the public.

Immediate Annuity
An annuity that commences payment to the annuitant at the end of the first prescribed payment period.

Inspection Report
A telephonic interview of the person applying for life insurance conducted by someone from the underwriting department of the insurance company. Some insurance companies only sporadically contact applicants and some contact every applicant. The questions asked relate to personal habits (such as smoking and alcohol consumption) and finances, including income and net worth, confirmation of employment, duties and the nature of the applicant's business.

Intestate
This means dying without a will, in which case the provincial laws of the province in which the death occurred apply to the manner in which assets will be distributed. In other words, if you do not write your own will, the government will do it for you after your death and it may not be as you would have wished.

Insured
A person, group or an organization covered by an insurance policy. In case of a life insurance, this is the person covered by the policy. On this person's death, a tax-free amount (benefit) will be paid to that person's named beneficiary.

Insurer
The party to the insurance contract who promises to pay losses or benefits.

Joint and Survivorship Annuity
An annuity which is payable to the named annuitants during the period of their joint lives which will continue to the survivor when the first annuitant dies.

Joint Insurance
Insurance written on two or more persons with benefits usually payable only at the first death

Joint Life Policies
Joint life policies cover two lives simultaneously.

Liquidity
A term used to describe the solvency of a business and which has special reference to the degree of readiness in which assets can be converted into cash without a loss. Also called cash position. If a firm's current assets cannot be converted into cash to meet current liabilities, the firm is said to be illiquid.

Lien
A legal right or encumbrance to secure payment performance on property, either personal or real, pledged as collateral until the debt/loan that it secures is satisfied.

Lease
A long-term rental agreement and a form of secured long-term debt.

Money Back Policies
Money-back policies provide for periodic payments of partial survival benefits during the term of the policy, as long as the policyholder is alive.

Money Market
A market where short-term securities are bought and sold. Commercial Paper, Certificate of Deposits, etc. are the instruments dealt with and the

players are banks, primary dealers, mutual funds and life insurance companies.

No-claims Bonus
In general insurance, a reduction in the price of an insurance policy, because no claims have been made on it.

Net Worth
The owner's equity in a given business represented by the excess of total assets over the total amounts owed to outside creditors (total liabilities) at a given time. In addition, the net worth of an individual as determined by deducting the amount of all his personal liabilities from the total value of his personal assets. Generally refers to tangible net worth, i.e., does not include goodwill, etc.

Net Asset Value (NAV)
The value of a mutual fund share as determined at the close of each business day. The mutual fund adds up the market value of all securities in its portfolio, deducts expenses, and divides this total by the number of shares outstanding. All shares redeemed on that day are done so at the NAV for that specific day.

Nominal Interest Rate
The annual amount received as interest from a fixed income security relative to the par value of the issue. Also referred to as nominal yield.

Online Banking
A system allowing individuals to perform banking activities at a choice of their location, via the internet.

Occupational Hazard
A condition in an occupation that increases the peril of accident, sickness, or death. This increases the amount of premium to be paid. Persons covered under this clause typically are deep sea divers, pilots, police officers, armed forces personnel, etc.

Policy

The legal document issued by the company to the policyholder, which outlines the conditions and terms of the insurance.

Paid-Up Insurance
Insurance on which all premiums are paid; however, the insurance has not yet matured, by either death or endowment.

Policy Term
That period for which an insurance policy provides coverage.

Premium
The sum paid by a policyholder secure an insurance policy and to keep it in force.

Probationary Period
A period from the policy date to a specified time, usually 15 to 30 days, during which no sickness coverage is effective.

Proposal
A person interested in taking out insurance has to make an offer by means of a proposal. This is an application for the cover required, or for obtaining quotations of the premium chargeable.

Premium
This is your payment for the cost of insurance. You may pay annually, semi-annually, quarterly or monthly.

Policy Fee
An administrative fee that is part of most life insurance policies. It ranges from about Rs. 50 per month to as much as Rs. 100 per month per policy. It is not a separate fee. It is incorporated in the regular monthly, quarterly, semi-annual or annual payment that you make for your policy.

Policyholder
The person who owns a life insurance policy. This is usually the insured person, but it may also be a relative of the insured, a partnership or a corporation. There are instances in marriage breakup (or relationship

breakup with dependent children) where appropriate life insurance on the support provider, owned and paid for by the ex-spouse receiving the support is an acceptable method of ensuring future security.

Probate
Represents judicial certification of the validity of a Will and judicial confirmation of the authority of the personal representative who is to administer the Will.

Par Value
For investment bonds, the par value of face amount is the amount due at maturity and is the amount on which interest is calculated. For shares, the par value is an arbitrary rupee value assigned to each share.

Paramedical Examination
A medical check up of a proposed insured for a life or health insurance policy done as part of the underwriting process. The examination is conducted by a medical professional, selected by the insurance company.

Policy Owner
The person who has the right to make changes guaranteed by the policy. The policy-owner may or may not be the person covered by the insurance policy.

Power of Attorney
A written instrument that empowers an individual to act on the behalf of another individual. The scope of the attorney's power may vary from being very specific ("only to execute a specific contract for me") to general ("to do anything I am legally able to do"). Normally given to execute some transaction.

Premium
The amount of money paid to the insurance company in return for insurance protection.

Present Value (Present Value of a Series of Payments)

The amount of money that would need to be invested today at a given interest rate (present value of a stream of future payments) to equal a predetermined sum at a future date.

Price/Book Ratio
A financial ratio that relates a company's share price to its total assets minus any fictitious assets minus all liabilities.

Price /Earning Ratio
A financial ratio that is commonly referred to as the P/E ratio or multiple. This is the relationship of a company's share price divided by earnings per share. It provides investors with an indication of how much is being paid (share price) for a company's earnings potential.

Primary Beneficiary
The first named beneficiary to receive the proceeds of the life insurance policy. The primary beneficiary must be alive at the death of the insured in order to collect.

Prospectus
A formal written document that provides a business plan and objective for a proposed business or investment opportunity, or historical information concerning an existing entity.

Prepayment
Payment of mortgage loan, or part of it, before due date.

Principal
The basic element of the loan as distinguished from interest and mortgage insurance premium. In other words, principal is the amount on which interest is paid.

Private Banking
The providing of banking services to very wealthy individuals and families. Many financial services firms require a person or family to have a certain minimum net worth to qualify for private banking services.

Rupee Cost Averaging
A way of smoothing out your investment deposits by investing regularly. Instead of making one large investment, you make smaller regular monthly deposits. If you are buying units in a mutual fund or unit linked life insurance, you would buy more units in the month when values were low and less units in the month when values were higher. By spreading out your purchases, you do not have to worry about buying at the right time.

Reinsurance
The operation of the insurance company insuring its commitments elsewhere with another insurance company.

Repatriation Expenses (Overseas medical insurance)
Expenses incurred to travel back to home country following sickness abroad.

Re-entry
A provision in some term insurance policies that allow the insured the right to renew the policy at a more favorable rate by providing updated evidence of insurability.

Reinstatement
The restoration of a lapsed life insurance policy. The life insurance company will require evidence of continuing good health and the payment of all past due premiums plus interest.

Replacement
This subject of replacement of existing policies is covered because, sometimes, existing life insurance policies are unnecessarily replaced with new coverage resulting in a loss of valuable benefits. If someone suggests replacing your existing coverage, insist on having a comparison disclosure statement completed.

Rule of 72
This is a very important rule to know. The rule is that the number 72 divided by the rate of return of your investment equals the number of years it takes for your investment to double.

For example:

- At 1% your money will double in 72 years
- At 2% your money will double in 36 years
- At 4% your money will double in 18 years
- At 6% your money will double in 12 years
- At 7% your money will double in 10.3 years
- At 8% your money will double in 9 years
- At 9% your money will double in 8 years

Re-insurance
A form of insurance that insurance companies purchase from other insurance companies. This is done to reduce the possible maximum loss on either an individual risk or a group of risks.

Riders
Additions or modification to the coverage of an insurance policy. The more common life insurance policy riders are as follows: Accidental Death, Cost of living adjustment, Child rider, Spouse rider, Return of premium, Critical illness, Waiver of premium, Disability, etc.

Risk
In Property and Casualty Insurance, risk refers to a peril (e.g., fire, windstorm or auto collision).

Risk Tolerance
A measurement of the amount of investment risk that an individual is willing to assume. This amount of risk may change for an individual as their personal and economic situation changes.

Reconciliation
Adjusting one's bankbook balance to match the bank's statement.

Retail Banking
Banking services for individual customers.

Retirement Annuity
A form of annuity contract that is entered into before a selected retirement age with the consideration paid in installments until that age is reached.

Rates (Variable)
Variable loan rates will generally change monthly or quarterly and are based on some index, such as the bank's prime rate.

Simple Interest
The method of computing interest on a principle sum where the interest rate is applied only to the original principal amount.

Single Premium Policy
A life insurance policy paid for in one single premium in advance rather than in annual premiums over time.

Superannuation
A situation where a retired individual outlives his or her income and financial resources.

Surrender Charge
A fee that is deducted from the account value of a life insurance policy or annuity contract when the policy or contract is surrendered. These charges generally decrease over time.

Subrogation
Conditional payments may be made by an insurance company to a general insurance claimant who has a loss of assets; however, the insurance company has a right to seek reimbursement of any payments they made to the claimant either from the third party or from any judgment or settlement received by the claimant from the third party.

Suicide Clause
Generally, a suicide clause in a regular life insurance policy provides for voiding the contract of insurance if the life insured commits suicide within two years of the date of issue of the coverage.

Simple Interest
The interest calculated on a principal sum, not compounded on earned interest.

Term Life Insurance
A plan of insurance that covers the insured for only a certain period and not necessarily for his or her entire life. The policy pays a death benefit only if the insured dies during the term.

Triple Protection
A form of Life Insurance that is usually a combination of Whole Life and twice as much Term Insurance.

Unearned Premium
The portion of a premium that a company has collected but has to earn because the policy still has unexpired time to run.

Unenforceable Contract
A contract that lacks some evidential features. Although the contract is valid, it is cannot not be enforced in a court of law.

Uninsurable Risk
One not acceptable for insurance due to excessive risk.

Underwriter
The person (broker or agent) who helps you choose the proper type of life insurance or disability insurance and the insurance company for your particular needs. This could also be the person at the insurance company's head office who reviews your application for coverage to determine whether the insurance company will issue a policy to you.

Vanishing Premium
Relates to unit linked life insurance and the use of the increase in the value of the investments to reduce or eliminate the need for future premiums. In the 2002-2007 boom, life insurance companies' profits from investments were exceedingly high compared with historical experience. It became common for a salesperson to show new prospective clients how quickly his or her insurance company's dividends would cover the future cost of future premiums. In some cases, more emphasis was put on the value of future growth than on the fact that future appreciation was not guaranteed and could only be projected. Many life insurance buyers have since learned that

the growth they expected in 2002-07 no longer exists; they continue to dig into their pockets to pay insurance premiums.

Viatical Settlement

A dictionary meaning for viatica is "the Eucharist as given to a dying person or to one in danger of death." In the context of Viatical Settlement, it means the selling of one's own life insurance policy to another in exchange for an immediate percentage of the death benefit. The person or in many cases, group of persons buying the rights to the policy have high expectation of the imminent death of the previous owner. The sooner the death of the previous owner, the higher the profit. The practice is common in the US and is likely to be prevalent in India. It would appear to have a definite conflict with India's historical view of 'insurable interest'.

Void Contract

A contract obtained by fraud is a void contract.

Waiver of Premium

An option available to the applicant for life insurance, which sets certain conditions under which an insurance policy will be kept in full force by the insurance company without the payment of premiums. Very specifically, a life insured would have to be totally disabled through injury or illness for a period of six months before the benefit kicks in. When it does, the insurance company retroactively pays premiums from the beginning of the disability until the time the insured is able to perform some form of regular activity.

Warranties

Warranties are expressly stated in the policy to ensure that the insured shall not do a particular thing. They protect insurers against any increase in the risk after the issue of the policy.

Will

This is a legal document detailing how you want your assets to be distributed on your death. You may also stipulate how you wish to be cremated / buried or who you would like to take care of any surviving dependent family members. It is very important to be quite specific about

your wishes for the distribution of special assets such as the antique grandfather clock, the classic silver tea set or the antique piano.