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STUDY MATERIAL (NFLAT)

BASICS OF BANKING

Commercial banks are an organisation which normally performs certain financial transactions. It performs the twin task of accepting deposits from members of public and make advances to needy and worthy people form the society.

A. Primary Functions of Banks

The primary functions of a bank are the main functions of a bank. These primary functions of banks are explained below.

1. Accepting Deposits

The bank collects deposits from the public. These deposits can be of different types, such as:-

A) Saving Deposits B) Fixed Deposits

C) Current Deposits D) Recurring Deposits

a. Saving Deposits

This type of deposits encourages saving habit among the public. The rate of interest is low. Withdrawals of deposits are allowed subject to certain restrictions. This account is suitable to salary and wage earners. This account can be opened in single name or in joint names.

b. Fixed Deposits

Lump sum amount is deposited at one time for a specific period. Higher rate of interest is paid, which varies with the period of deposit. Withdrawals are not allowed before the expiry of the period. Those who have surplus funds go for fixed deposit.

c. Current Deposits

This type of account is operated by businessmen. Withdrawals are freely allowed. No interest is paid. In fact, there are service charges. The account holders can get the benefit of overdraft facility.

d. Recurring Deposits

This type of account is operated by salaried persons and petty traders. A certain sum of money is periodically deposited into the bank. Withdrawals are permitted only after the expiry of certain period. A higher rate of interest is paid.

2. Granting of Loans and Advances

The bank advances loans to the business community and other members of the public. The rate charged is higher than what it pays on deposits. The difference in the interest rates (lending rate and the deposit rate) is its profit.

The types of bank loans and advances are :-

a. Overdraft b. Cash Credits c. Loans d. Discounting of Bill of Exchange

a. **Overdraft**

This type of advances are given to current account holders. A certain amount is sanctioned as overdraft which can be withdrawn within a certain period of time say three months or so. Interest is charged on actual amount withdrawn. An overdraft facility is granted against a collateral security. It is sanctioned to businessman and firms.

b. Cash Credits

The client is allowed cash credit upto a specific limit fixed in advance. It can be given to current account holders as well as to others who do not have an account with bank. Separate cash credit account is maintained. Interest is charged on the amount withdrawn in excess of limit. The cash credit is given against the security of tangible assets and / or guarantees. The advance is given for a longer period and a larger amount of loan is sanctioned than that of overdraft.

c. Loans

It is normally for short term say a period of one year or medium term say a period of five years. Now-a-days, banks do lend money for long term. Repayment of money can be in the form of instalments spread over a period of time or in a lump sum amount. Interest is charged on the actual amount sanctioned, whether withdrawn or not. The rate of interest may be slightly lower than what is charged on overdrafts and cash credits. Loans are normally secured against tangible assets of the company.

d. Discounting of Bills of Exchange

The bank can advance money by discounting or by purchasing bills of exchange both domestic and foreign bills. The bank pays the bill amount to the drawer or the beneficiary of the bill by deducting usual discount charges. On maturity, the bill is presented to the drawee or acceptor of the bill and the amount is collected.

B. Secondary Functions of Banks ↓

The bank performs a number of secondary functions, also called as non-banking functions.

These important secondary functions of banks are explained below.

1. Agency Functions

The bank acts as an agent of its customers. The bank performs a number of agency functions which includes:-

a. Transfer of Funds
b. Collection of Cheques
c. Periodic Payments
d. Portfolio Management
e. Periodic Collections
f. Other Agency Functions

a. Transfer of Fund

The bank transfer funds from one branch to another or from one place to another.

b. Collection of Cheques

The bank collects the money of the cheques through clearing section of its customers. The bank also collects money of the bills of exchange.

c. Periodic Payments

On standing instructions of the client, the bank makes periodic payments in respect of electricity bills, rent, etc.

d. Portfolio Management

The bank also undertakes to purchase and sell the shares and debentures on behalf of the clients and accordingly debits or credits the account. This facility is called portfolio management.

e. Periodic Collections

The bank collects salary, pension, dividend and such other periodic collections on behalf of the client.

f. Other Agency Functions

They act as trustees, executors, advisers and administrators on behalf of its clients. They act as representatives of clients to deal with other banks and institutions.

2. General Utility Functions

The bank also performs general utility functions, such as :-

a. Issue of Drafts, Letter of Credits, etc.
b. Locker Facility
c. Underwriting of Shares
d. Dealing in Foreign Exchange
e. Project Reports
f. Social Welfare Programmes
g. Other Utility Functions

a. Issue of Drafts and Letter of Credits

Banks issue drafts for transferring money from one place to another. It also issues letter of credit, especially in case of, import trade. It also issues travellers' cheques.

b. Locker Facility

The bank provides a locker facility for the safe custody of valuable documents, gold ornaments and other valuables.

c. Underwriting of Shares

The bank underwrites shares and debentures through its merchant banking division.

d. Dealing in Foreign Exchange

The commercial banks are allowed by RBI to deal in foreign exchange.

e. Project Reports

The bank may also undertake to prepare project reports on behalf of its clients.

f. Social Welfare Programmes

It undertakes social welfare programmes, such as adult literacy programmes, public welfare campaigns, etc.

g. Other Utility Functions

It acts as a referee to financial standing of customers. It collects creditworthiness information about clients of its customers. It provides market information to its customers, etc. It provides travellers' cheque facility.

Features of Cheque

1) A cheque must be in writing. It can be written in ink pen, ball point pen, typed or even printed. Oral orders are not considered as cheques.
2) Every cheque contains an unconditional order issued by the customer to his bank. It does not contains a request for payment
3) A cheque is always drawn on a specific bank mentioned therein.
4) A cheque must be signed by customer (Account holder) .
5) A cheque when presented for payment must be paid on demand.
6) The amount to be paid by the banker must be certain. It must be written in words and figures.
7) The name of the payee must be written on the cheque or it can be made payable to bearer.
8) A cheque must be duly dated by the customer of bank.
9) Cheque has 3 parties:-
    1. Drawer : A drawer is a person, who draws a cheque.
    2. Drawee : A drawee is a bank on whom a cheque is drawn.
    3. Payee : A payee is a person in whose favour a cheque is drawn.

Crossed cheque

A crossed cheque is a cheque that is payable only through a collecting banker and not directly at the counter of the bank. Crossing ensures security to the holder of the cheque as only the collecting banker credits the proceeds to the account of the payee of the cheque.

When two parallel transverse lines, with or without any words, are drawn generally, on the left hand top corner of the cheque. A crossed cheque does not affect the negotiability of the instrument.

It warns the collecting banker that the proceeds are to be credited only to the account of the payee, or the party named on the cheque, or his agent.

Two parallel lines are made in corner of the cheque. It can be endorsed. For ex. A issued crossed cheque in favour of B. Now B can endorse this cheque in favour of C by signing on its back and C can get money into his account even if cheque is in name of B.

In between those parallel lines if 'account payee' is also written. In above ex., if cheque is account payee, B cannot endorse in favour of any other person. The money will go into B's account only.

Difference between Cheque and draft

	Cheque	Draft
Facility	The current and saving account holders get a cheque facility.	Draft is issued to anyone even to non-account holders
Purpose	Cheques are used to make payments or to settle transactions. There is no certainty of payment in the case of cheques as they can be dishonoured or payment can be stopped.	The main purpose of a draft is to transfer money from one place to another or to guarantee the certainty of payment to the payee.
Drawer	In case of cheque, the drawer is the customer of the bank	In case of draft, the drawer is the bank itself.
Bank charges	The bank may not charge for issuing the cheque book.	The bank charges a nominal fee or commission to issue a draft.
Dishonour	Cheques can be dishonoured for various reasons	There is no question of dishonouring of draft.
Stopping of payment	In case of cheque, the drawer can ask the bank to stop payment of the cheque even if it is delivered to the payee.	In case of draft, the purchaser of the draft can ask the bank to stop payment before the draft is delivered to the payee.
Clearance	In case of cheque, there is a need for clearance.	In case of a draft, there is no need for clearance, if DD is drawn on the same bank.
Parties involved	Three parties are involved in cheque transaction viz., (a) Drawer, (b) Drawee, and (c) Payee.	Two parties are involved in draft transaction viz., (a) Drawer, and (b) Payee.

Permanent Account Number (PAN) is a code that acts as identification of Indians, especially those who pay Income Tax. It is a unique, 10-character alpha-numeric identifier, issued to all judicial entities identifiable under the Indian Income Tax Act 1961. An example number would be in the form of **ARLPA0061H**. It is issued by the Indian Income Tax Department under the supervision of the Central Board for Direct Taxes (CBDT) and it also serves as an important proof of identification.

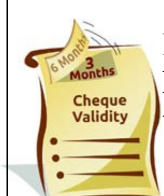
Safety Measures: What are the do's and don'ts of using cheques?

Do's

- Write clearly and legibly and always use permanent ink pens such as a ball pen.
- Ensure no alteration/amendment/erasure on the face of the cheque as banks will reject such cheques
- Begin writing the amount in words without leaving too much space in between the words written and always write the amount payable ending with the word "only". The amount in figures should be written legibly
- Make sure that no cheque is being removed from the cheque book without your knowledge and ensure that spoiled cheques are completely destroyed
- Ensure that cheques are kept in a safe and locked place and never leave cheques whether signed or unsigned unattended
- Undertake regular review of your stock of unused cheques and conduct regular reconciliation of cheques paid with your bank statement
- Report immediately to your bank if there are cheques missing from your cheque book or discrepancies in your bank statement
- Ensure your account has sufficient funds before you issue a cheque. It is not the duty of your bank to call you when there are insufficient funds although some banks may do so as part of their service to their customers

Don'ts

- Write below the MICR (Magnetic Ink Character Recognition) field of the cheque to allow smooth clearing of your cheque. The MICR field is usually a 5/8 inch band at the bottom of the cheque
- Sign any blank cheque or give any blank cheque as payment
- Use laser printer, felt tip pen, erasable pen or pencil or other printing techniques which can be easily erased and written over, to write details on a cheque. If you are using a typewriter, you should not use correctable ribbons
- Fold, pin or staple written cheques. If the cheque is folded, the clarity of the wordings which fall across the "folded" lines may be affected. In addition, folding may break the MICR field of the cheque, resulting in the cheque being rejected by the cheque processing system. Cheques should not be stapled to prevent accidental tearing



If you often **delay depositing your cheques** for credit into your bank account, be warned. From 1 April 2012, cheques, drafts, pay orders and banker's cheques are valid for only three months.

Banks will have to mention the three-month validity on cheques and drafts.

Money

Money is any item or verifiable record that is generally accepted as payment for goods and services and repayment of debts in a particular country or socio-economic context, or is easily converted to such a form.

OR

Money is anything which is generally accepted as a medium of exchange, measure of value, store of value and means for standard of deferred payment (payments which are to be made in future).

Medium of exchange

When money is used to intermediate the exchange of goods and services, it is performing a function as a *medium of exchange*. It thereby avoids the inefficiencies of a barter system, such as the "coincidence of wants" problem. Money's most important usage is as a method for comparing the values of dissimilar objects.

Measure of value

Money acts as a common measure of value into which values of all goods and services are expressed and compared. When we measure the value of a commodity in terms of money, it is known as Price.

Store of value

To act as a *store of value*, money must be able to be reliably saved, stored, and retrieved – and be predictably usable as a medium of exchange when it is retrieved. The value of money must also remain stable over time.

Standard of deferred payments : Deferred payments refer to those payments which are to be made in future. Suppose you borrow a sum of Rs. 20,000 at 10 % p.a. interest for one year. It means you promise to pay Rs.22,000 (Rs.20,000 as principal and Rs.2,000 as interest) after one year. Money serves as a standard of such future payments.

Net worth

Net worth is the total assets minus total outside liabilities of an individual or a company. Net worth is used when talking about the value of a company or in personal finance for an individual's net economic position.

Liability

Liability is defined as the future sacrifices of economic benefits that the entity is *obliged* to make to other entities as a result of past transactions or other *past* events, the settlement of which may result in the transfer or use of assets, provision of services or other yielding of economic benefits in the future.

OR

In accounting terms , liability describes an obligation. It refers to money owed to complete a transaction, debt that has yet to be paid, or products or services that have been paid for but have not yet been rendered.

Asset

An **asset** is an economic resource. Anything tangible or intangible that can be owned or controlled to produce value and that is held to have positive economic value is considered an asset. Simply stated, assets represent value of ownership that can be converted into cash (although cash itself is also considered an asset).

- Assets = Liabilities + Capital (where Capital for a corporation equals Owner's Equity)
- Liabilities = Assets – Capital
- Capital = Assets – Liabilities

The difference between Wealth and Money

Wealth is a measure of all the goods and services produced by an economy. Such as: cars, homes, bread. It also includes any services anybody was willing to hire. Such as: Medical, education. Wealth is what we desire: goods and service. Money is a tool we use to exchange those goods and services between each other. Giving everyone more money does not necessarily result in everyone getting more wealth. The wealth is created when people start trading that money with each other in exchange for more goods and services. So money changing hands can create wealth, but the act of having money doesn't do it. Some people hoard money to obtain future wealth. Money is a tool, and is not a typical commodity. Granted, it sometimes behaves like a commodity, but it has no intrinsic value (Value as a commodity). Creating wealth should always be the goal, and money should be seen as nothing but a tool used to achieve that goal.

Personal financial planning is the process of managing your money to achieve personal economic satisfaction. This planning process allows you to control your financial situation. Every person, family, or household has a unique financial position, and any financial activity therefore must also be carefully planned to meet specific needs and goals.

A comprehensive financial plan can enhance the quality of your life and increase your satisfaction by reducing uncertainty about your future needs and resources. The specific advantages of personal financial planning include

- Increased effectiveness in obtaining, using, and protecting your financial resources throughout your lifetime.
- Increased control of your financial affairs by avoiding excessive debt, bankruptcy, and dependence on others for economic security.
- Improved personal relationships resulting from well-planned and effectively communicated financial decisions.
- A sense of freedom from financial worries obtained by looking to the future, anticipating expenses, and achieving your personal economic goals.

Your financial goals should take a **<u>S-M-A-R-T</u>** approach i.e. goals should be SMART -

S - *specific,* so you know exactly what your goals are so you can create a plan designed to achieve those objectives.

M - *measurable* with a specific amount. For example, “Accumulate Rs. 5,000 in an investment fund within three years” is more measurable than “Put money into an Investment fund.”

A - achievable No one has ever built a billion dollar business over night. Dream big and aim for the stars but keep one foot firmly based in reality.

R - *realistic,* involving goals based on your income and life situation. For example, it is probably not realistic to expect to buy a new car each year if you are a full-time student.

T - *time-based,* indicating a time frame for achieving the goal, such as three years. This allows you to measure your progress toward your financial goals.

BUDGETING : BALANCING THE MEANS AND THE ENDS

Meaning- It is the process of preparing a detailed statement of financial results that are expected for a given period of time in the future.

The key words in the above statement are:

Expected- means something that is likely to happen.

Future- A period in the time to come

Budgeting time periods- A budget is prepared for short, mid-range and longer term periods. A common set of time periods may be a month, a quarter or a year.

Types of Budgeting in a business firm- The three most important types of budgeting that a business firm should practice are:

1. Capital budgeting.
2. Operating budget.
3. Cash Flow budget.

Capital budgeting- It is the budgeting for the large expenses in the business firm. It is the process of budgeting for obtaining , expanding and replacing fixed assets. Fixed assets are those which are used in the business for a long period of time and increases the profit earning capacity of the business. For example - land and building, machinery, furniture etc.

Operating budget- It is a budget of sales revenue minus expenses.

Cash flow budget- It is a budget showing expected cash inflows(receipts) and cash outflows(expenses). The cash flow budget shows whether or not enough cash will be available to meet monthly expenses. If not ,the cash flow budget shows how you can borrow if you don't have enough money to meet expenses and how you can invest if you have more money than you require in a given month.

Income : It is the sum of all the wages ,salaries ,profits interest payments ,rent and other forms of earnings received.

Now lets know how budgeting is related to you. For that lets answer a few frequently asked queries which will be useful to you:

What is a budget?

A blueprint of one's future projection(estimate) of income and expenditure.

What is the need for preparing a budget?

- To maximize savings.
- To avoid wasteful expenditure.
- To allocate funds to various areas of expenditure in advance.

What is budget surplus or deficit?

You might have heard these terms before when the government presents its annual budget.

Surplus= Estimated income > Estimated expenditure

Deficit= Estimated expenditure >Estimated income.

Now a few more things that will really help you to plan and prioritize your needs or wants

What is a need? Needs are necessities. Like a bicycle is a need .

What is a want? Wants make your life more comfortable. Like having a bike.

Let's take an example to understand this better:

The family of Mrs and Mr Sharma have the following family demands-

1. Elder son is demanding a bike for commuting to the college.
2. Younger son is demanding for a latest smart phone.
3. Mrs Sharma's birthday is approaching and her husband is thinking of gifting a diamond set.
4. The couple also wants to renovate their house.

In this example you will have to analyze the demands and prioritize them on the basis of importance and urgency

1. Like the elder son's demand is justified and it can be instantly satisfied .This is known as instant satisfaction i.e. buying something when you want it.
2. Younger son was convinced by telling him that he will be given a laptop in future and he agreed. This is known as Opportunity cost. Opportunity cost means to give up something to achieve something else in future.
3. Mrs Sharma's gift can be postponed.
4. The last wish can be ignored for the time being.

On the basis of prioritization only you will understand what are the needs and what are the wants. Needs are to be fulfilled instantly whereas wants can be postponed or ignored.

Delayed gratification, or **deferred gratification**, is the ability to resist the temptation for an immediate reward and wait for a later more enduring reward.

Examples: Saving now to spend later, choosing healthy to get energy later, or putting up with studies to help boost your career later

Instant gratification

Instant gratification is the desire to experience pleasure or fulfilment without delay or deferment. Basically, it's when you want it; and you want it now.

Instant gratification is the opposite of what we've been taught and try too hard to practice — delayed gratification. Waiting is hard, and there is an innate desire to have what we want when we want it, which is usually without any delay.

UNDERSTANDING INSURANCE AND RISK MANAGEMENT

Insurance is a means of protection from financial loss. It is a form of risk management primarily used to hedge against the risk of a contingent, uncertain loss.

An entity which provides insurance is known as an insurer, insurance company, or insurance carrier. A person or entity who buys insurance is known as an insured or policyholder. The insurance transaction involves the insured assuming a guaranteed and known relatively small loss in the form of payment to the insurer in exchange for the insurer's promise to compensate the insured in the event of a covered loss. The loss may or may not be financial, but it must be reducible to financial terms, and must involve something in which the insured has an insurable interest established by ownership, possession, or pre-existing relationship.

The insured receives a contract, called the insurance policy, which details the conditions and circumstances under which the insured will be financially compensated. The amount of money charged by the insurer to the insured for the coverage set forth in the insurance policy is called the premium. If the insured experiences a loss which is potentially covered by the insurance policy, the insured submits a claim to the insurer for processing by a claims adjuster.

Difference between Pure risk and Investment Risk

Pure Risk: Any risk in which there is no possibility of gain, only the avoidance of loss. For example, if a company car is stolen, the company endures a loss, but if it is not stolen, the company does not make a gain. Individuals and companies purchase insurance to mitigate the potential damage from a loss from pure risk. It is also called absolute risk

Investment risk: can be defined as the probability or likelihood of occurrence of losses relative to the expected return on any particular investment. Stating simply, it is a measure of the level of uncertainty of achieving the returns as per the expectations of the investor. It is the extent of unexpected results to be realized.

Basis	Pure Risk	Speculative/ Investment Risk
Meaning	Pure risk involves no possibility of gain; either a loss occurs or no loss occurs	Speculative Risk involves three possible outcomes: loss, gain or no change
Example	An example of pure risk is the risk of becoming disabled as a result of illness or injury.	Trading in stock market may result in making either a profit or loss or neither a profit nor loss i.e. no change in the investment value.
Insurance	Pure risk - the risk of loss without the possibility of gain- is the only type of risk that can be insured.	Speculative Risk cannot be insured

Ways of Managing Risk

There are four main ways to manage risk: risk avoidance, risk transfer, risk reduction and risk retention. Each is applicable under different circumstances. Some ways of managing risk fall into multiple categories. Multiple ways of managing risk are often utilized simultaneously.

Risk Avoidance (elimination of risk)

Completely avoiding an activity that poses a potential risk. While attractive, this is not always practical. By avoiding risk we forfeit potential gains be it in life, in business or in with investments.

Risk Transfer (insuring against risk)

Most commonly, this is to buy an insurance policy. The risk is transferred to a third-party entity (in most cases an insurance company).To be more clear, the financial risk is transferred to a third-party. For example, a homeowner's insurance policy does not transfer the risk of a house fire to the insurance company, it only transfers the financial risk. A house fire is still just as likely as before. Risk sharing is also a type of risk transfer. For example, members assume a smaller amount of risk by transferring and sharing the remainder of risk with the group.

Risk Reduction (mitigating risk)

This is the idea of reducing the extent or possibility of a loss. This can be done by increasing precautions or limiting the amount of risky activity. For example, installing a security alarm, smoke detectors, wearing a seat belt or wearing a helmet are ways of employing risk reduction. Diversification of assets and hedging are forms of risk reduction with investments. Investments in information are a way of mitigating risk because you are better informed, thus reducing the uncertainty. Another way of employing risk reduction is the safety in numbers approach. When discussing risk transfer, we spoke briefly about risk sharing. The larger the number of people sharing risk, the less severe the shared effects will be. Statistically, only a small number of individuals in the group will experience an unfortunate event. Insurance companies exist based on this concept.

Risk Retention (accepting risk)

Risk retention simply involves accepting the risk. Even if the risk is mitigated, if it is not avoided or transferred, it is retained. Retention is effective for small risks that do not pose any significant financial threat. The financial status of the family or individual will determine the acceptability of a risk. A couple of examples of risk retention: A billionaire may not have to worry about insuring his car. An individual may not be able to afford or obtain health insurance. Both individuals are retaining risk, one is because they're able to, the other is because they have to. Risk retention augments risk transfer through deductibles. With a deductible, we retain or 'self-insure' small, frequent occurrences and only utilize insurance for needs over a particular dollar threshold, our deductible limit.

Diversification of Risk

Allocation of proportional risk to all parties to a contract, usually through a risk premium. Also called risk allocation

Insurance Glossory

Indemnity

Indemnity implies compensation for damages or losses. The concept of indemnity is based on a contractual agreement made between two parties, in which one party agrees to pay for potential losses or damages caused to the other party. A typical example is an insurance contract, whereby one party (the insurer) agrees to compensate the other (the insured) for any damages or losses, in return for premiums paid by the insured to the insurer.

Sum Assured

Sum assured is the amount that an insurer agrees to pay on the occurrence of a stated contingency (e.g. death).

Premium

Insurance is nothing but a risk transfer mechanism wherein the person purchasing insurance transfers his/her risk to the insurance company in return for a payment known as the Premium.

Term Life Insurance

Term life insurance or term assurance is life insurance that provides coverage at a fixed rate of payments for a limited period of time, the relevant term. After that period expires, coverage at the previous rate of premiums is no longer guaranteed and the client must either forgo coverage or potentially obtain further coverage with different payments or conditions. If the life insured dies during the term, the death benefit will be paid to the beneficiary. Term insurance is the least expensive way to purchase a substantial death benefit on a coverage amount per premium dollar basis over a specific period of time.

Term life insurance can be contrasted to permanent life insurance such as whole life, universal life, and variable universal life, which guarantee coverage at fixed premiums for the lifetime of the covered individual unless the policy owner allows the policy to lapse. Term insurance is not generally used for estate planning needs or charitable giving strategies but is used for pure income replacement needs for an individual. Term insurance functions in a manner similar to most other types of insurance in that it satisfies claims against what is insured if the premiums are up to date and the contract has not expired and does not provide for a return of premium dollars if no claims are filed. As an example, auto insurance will satisfy claims against the insured in the event of an accident and a homeowner policy will satisfy claims against the home if it is damaged or destroyed by, for example, a fire. Whether or not these events will occur is uncertain. If the policyholder discontinues coverage because he has sold the insured car or home, the insurance company will not refund the full premium. This is purely risk protection.

Types of Life Insurance

There are certain basic forms of life insurance. The different types of life insurance policies include:

1. Term Life Insurance
2. Whole Life Policy
3. Endowment Plans
4. Unit Linked Insurance Plans
5. Money Back Policy

What are the various types of life insurance?

There are two basic types of life insurance policies viz. Traditional Whole Life and Term Life Insurance. A whole life is a policy you pay till death of the policy holder and term life is a policy for a fixed amount of time.

The basic types of life insurance policies are:

Term insurance

Term plans are the most basic form of life insurance. They provide life cover with no savings/ profits component. They are the most affordable form of life insurance as premiums are cheaper compared to other life insurance plans.

Online term insurance plans provide pure risk cover, which explains the lower premiums. A fixed sum of money - the sum assured – is paid to the beneficiaries if the policyholder expires over the policy term. If the policyholder survives, there is no pay out.

Endowment plans

Endowment plans differ from term plans in one critical aspect i.e. maturity benefit.Unlike term plans which pay out the sum assured along with profits, only in case of an eventuality over the policy term, endowment plans pay out the sum assured under both scenarios – death and survival. However, endowment plans charge higher fees / expenses – reflected in premiums – for paying out sum assured, along with profits, in either scenario – death or maturity. The profits are an outcome of premiums being invested in asset markets – equities and debt.

Unit linked insurance plans (ULIP)

ULIPs are a variant of the traditional endowment plan. They pay out the sum assured (or the investment portfolio if its higher) on death/maturity.

ULIPs differ from traditional endowment plans in certain areas. As the name suggests, performance of ULIP is linked to markets. Individuals can choose the allocation for investments in stock/debt markets. The value of the investment portfolio is captured by the NAV (net asset value). To that end, there are many similarities between ULIPs and mutual funds. ULIPs differ in one area, they are a combination of investment and insurance, while mutual funds are a pure investment avenue

Whole life policy

A whole life insurance policy covers a policyholder over his life. The main feature of a whole life policy is that the validity of the policy is not defined so the individual enjoys the life cover throughout his life. The policyholder pays regular premiums until his death, upon which the corpus is paid out to the family. The policy expires only in case of an eventuality as there is no pre-defined policy tenure.

Money back policy

A money back policy is a variant of the endowment plan. It gives periodic payments over the policy term. To that end, a portion of the sum assured is paid out at regular intervals. If the policy holder survives the term, he gets the balance sum assured. In case of death over the policy term, the beneficiary gets the full sum assured.

General Insurance

General insurance or non-life insurance policies, including automobile and homeowners policies, provide payments depending on the loss from a particular financial event. General insurance is typically defined as any insurance that is not determined to be life insurance

Vehicle Insurance

Vehicle insurance (also known as **car insurance**, **motor insurance** or **auto insurance**) is insurance for cars, trucks, motorcycles, and other road vehicles. Its primary use is to provide financial protection against physical damage and/or bodily injury resulting from traffic collisions and against liability that could also arise there from. The specific terms of vehicle insurance vary with legal regulations in each region. To a lesser degree vehicle insurance may additionally offer financial protection against theft of the vehicle and possibly damage to the vehicle, sustained from things other than traffic collisions, such as keying and damage sustained by colliding with stationary objects.

Medical or Health Insurance

Health insurance is a type of insurance coverage that pays for medical and surgical expenses incurred by the insured. Health insurance can reimburse the insured for expenses incurred from illness or injury, or pay the care provider directly. It is often included in employer benefit packages as a means of enticing quality employees. The cost of health insurance premiums is deductible to the payer, and benefits received are tax-free.

Property Insurance

Property insurance provides protection against most risks to property, such as fire, theft and some weather damage. This includes specialized forms of insurance such as fire insurance, flood insurance, earthquake insurance, home insurance, or boiler insurance. Property is insured in two main ways—open perils and named perils.

Open perils cover all the causes of loss not specifically excluded in the policy. Common exclusions on open peril policies include damage resulting from earthquakes, floods, nuclear incidents, acts of terrorism, and war. Named perils require the actual cause of loss to be listed in the policy for insurance to be provided. The more common named perils include such damage-causing events as fire, lightning, explosion, and theft.

Disability Insurance

Definition 1:

Disability Insurance, often called **DI** or **disability income insurance**, or **income protection**, is a form of insurance that insures the beneficiary's earned income against the risk that a disability creates a barrier for a worker to complete the core functions of their work. For example, the worker may suffer from an inability to maintain composure in the case of psychological disorders or an injury, illness or condition that causes physical impairment or incapacity to work. It encompasses paid sick leave, short-term disability benefits (STD), and long-term disability benefits (LTD)

Definition2:

Insurance policy that pays disability benefit as a partial replacement of income lost due to illness or injury. Most disability insurance policies pay a fixed sum for a fixed period, while others pay a monthly sum for the entire period the insured is disabled from earning suitable income (as determined by his or her qualifications, experience, and training).

Definition 3: Disability insurance is designed to replace a portion of your income if you become disabled and are unable to earn an income. A disability can result from a number of causes, including an injury, a serious illness or a mental health issue, and the duration of a disability can be either short or long term.

There are different kinds of disability insurance coverage, including individual insurance plans and group insurance plans, as well as government plans such as workers' compensation and benefits provided under the Canada Pension Plan.

Section 14 of IRDAI Act, 1999 lays down the duties, powers and functions of IRDAI.

1. Subject to the provisions of this Act and any other law for the time being in force, the Authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business.
2. Without prejudice to the generality of the provisions contained in sub-section (1), the powers and functions of the Authority shall include, -

- issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;
- protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
- specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents
- specifying the code of conduct for surveyors and loss assessors;
- promoting efficiency in the conduct of insurance business;
- promoting and regulating professional organisations connected with the insurance and re-insurance business;
- levying fees and other charges for carrying out the purposes of this Act;
- calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the insurance business;
- control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);
- specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;
- regulating investment of funds by insurance companies;
- regulating maintenance of margin of solvency;
- adjudication of disputes between insurers and intermediaries or insurance intermediaries;
- supervising the functioning of the Tariff Advisory Committee;
- specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations referred to in clause (f);
- specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and
- exercising such other powers as may be prescribed'

RETIREMENT AS A FINANCIAL GOAL

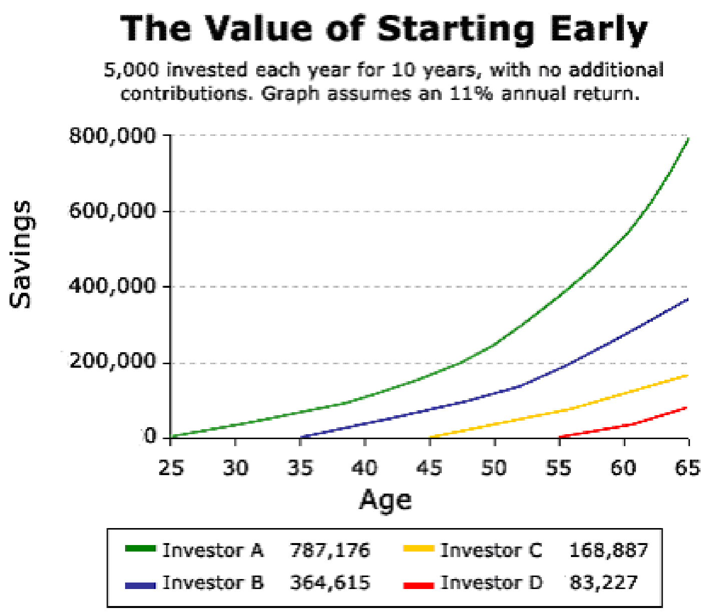
Retirement: is a stage in the life cycle of an individual when one stops being an active part of the productive/ working population on account of advanced age. Every individual aspires to lead a life of dignity and financial independence even after one retires. However, one needs to plan for the same. In fact, one of the most important reasons to save during one's working years is to provide for a financially independent and dignified post retirement life.

Retirement planning: Planning for the purpose of achieving financial independence after retirement.

Pension: Regular income to the individual after retirement.

Retirement planning requires:

1. To determine how much annual income will be needed in each year after retirement.
2. To determine how much must be accumulated in retirement savings in order to fund the expenditure during retired years.
3. To determine how much must be contributed to retirement savings in each remaining working years in order to accumulate the required amount determined in step #2.



<u>Type Of Pension Plans</u>

Defined Benefit (DB)

Defined Benefit Pension plan is one in which a specified monthly benefit (payment) is available on retirement. It is predetermined by a formula based on the employee's earning history, tenure of service and age, e.g. 50% of last pay drawn is paid as pension to central government employees (pre 01.01.2004).

Defined Contribution (DC)

Defined Contribution Pension plan in which the pension amount is dependent upon the aggregated retirement corpus which in turn is determined by the amount of individual contribution. Individual contributes for her/his own pension & parallely contribution can also come from employer/Central or State Government in addition to individual contribution. The amount of contribution is predetermined.

Two phases of retirement :

Accumulation phase - This period begins when you enter the workforce and begin setting aside funds for later years of your life, and ends when you actually retire.Basically, if you're still working, you're still in the accumulation phase, building wealth to get you through retirement. It is during this time that you're building wealth and resources to provide an income source for your post retirement.

Distribution phase - When you actually retire and start collecting money from the retirement income sources you set up during the accumulation phase of your life, you can be said to have entered the distribution phase.

There are many reasons why planning for retirement is important like any other goals:

1. **Increase in life expectancy:** Our generation will live longer than previous ones due to improved medical and healthcare, implying the need to gather enough funds that can sustain longer life. This also implies that the healthcare needs and expenses are likely to haunt us.
2. **Shortfall in Employer Funded Pension/Pension Funds :** The employer or government funded pension schemes are less likely to sustain the income needs post retirement. This is the reason many individuals supplement their state or employer funded retirement plans with self-funding- i.e. pension plans.
3. **Change of social structures:** In spite of family support, many retirees don't prefer depending on the relatives or children for meeting post retirement expenses. Maintaining independent lifestyle is sustainable only when backed with a financial cushion.
4. **Lack of social security system:** There is no social security system in our country. Hence one has to plan to build the entire corpus to help meet the regular income or any contingency post retirement.
5. **Rest and relaxation:** After fulfilling all your responsibilities, you may want to build a retirement corpus to go on holidays, to pursue a hobby etc.

Pension Fund Regulatory and Development Authority(PFRDA)

PFRDA was established by Government of India on 10th October 2003, PFRDA to act as a regulator for the pension sector.The mandate of PFRDA is development and regulation of pension sector in India.

Functions of Pension Fund Regulatory and Development Authority

- Promote pension scheme in the country by fostering mandatory as well as voluntary pension schemes in order to serve the old age income needs of retired personnel
- National Pension System, both tier 1 and tier 2 are under the purview of PFRDA and are dictated by the same
- PFRDA performs the function of appointing various intermediate agencies like Pension Fund Managers, Central Record Keeping Agency (CRA) etc.
- Educating the general public and stakeholders about the importance of pension.
- Training of intermediaries that perform the task of popularizing and educating people about the importance of pension.
- Addressing grievances related to various pension schemes in the country.
- Addressing and resolving disputes between various intermediaries.

Powers of PFRDA

The Ordinance has empowered the PFRDA to regulate the New Pension System (NPS), as amended by the Central Government from time to time. The PFRDA would also prescribe guidelines on the number of players, prudential norms, investment criteria and capital requirement of pension fund managers.

Besides framing regulations/guidelines and prescribing disclosure standards, the PFRDA has also been empowered to curb fraudulent and unfair practices in pension funds and protect the interests of the subscribers to the schemes of pension funds. All appeals against the orders and decisions of PFRDA would lie with the Securities and Appellate Tribunal.

The New Pension System (NPS)

The New Pension System is changed to National Pension System. NPS is made available to all Citizen of India w.e.f 1.5.2009 on a voluntary basis and 16 Lakh State Government employees from 22 States are covered under National Pension System (NPS).

Features and architecture of the national pension system

1. The National Pension System is based on defined contributions. Subscriber can open NPS account through POP or Aggregator. NPS tier-1 Account is non withdrawal account and there will be seamless transfer of accumulations in case of change of employment and/or location. It will also offer a basket of investment choices and Fund managers.
2. NPS is mandatory for new recruits in the Central Government service (except the armed forces). The monthly contribution would be 10 percent of the salary and DA to be paid by the employee and matched by the Central Government.
3. National Securities Depository Service Limited (NSDL) has been appointed as the Central record keeping agency (CRA) under NPS .The recordkeeping, administration and customer service functions for all subscribers of the NPS shall be centralized and performed by the CRA.
4. Pension Fund Managers (PFMs) are appointed by PFRDA to manage the retirement savings of subscribers.
5. Annuity Service Providers (ASPs) are appointed by PFRDA for delivering a regular monthly pension to the subscriber for the rest of his/her life post retirement.
6. Individuals exit at attainting the age of 60 years from the NPS. At exit, the individual is required to invest minimum 40 percent of pension wealth to purchase a pension from ASP. The individual would receive a lump-sum of the remaining pension wealth, which she would be free to utilize in any manner; individuals have the facility to invest more than the minimum prescribed 40% for receiving higher pension. Individuals would have the flexibility to leave the NPS prior to age 60. However, in this case, the mandatory annuitisation would be 80% of the pension wealth.

SwavalambanYojana is launched by Government of India on 26.09.2010 to support individuals in the unorganized sector in achieving old age security. Any citizen of India, belonging to the unorganized sector, is eligible to open a NPS account subject to the following conditions:

- Subscriber should be between 18 — 60 years of age.
- Subscriber should not be covered under any social security scheme.

Government of India will contribute Rs 1000 per annum to all eligible NPS Swavalamban accounts where the subscriber deposits a minimum of Rs 1000 to maximum Rs. 12000/- per annum. The incentive is presently available till 2016-17 and around 16 Lakh subscribers are covered under this scheme till 2012-13.

Understanding Investment

Investment: It is an asset or item that is purchased with the hope that it will generate income or appreciate in future.

Process of Investing Money: The extra fund which we earn can be invested in shares, debentures, bonds, bank deposits, mutual funds and property to earn a higher return. If you opt for a safe investment you may invest your savings in bank deposits for different periods with varied rate of interest or if you are willing to take risk you may invest in capital market in shares, debentures, bonds or mutual funds.

Three Pillars of Investment:

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

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

Growth: When we invest money we get some extra money in return, it is called interest on investment. This interest increases the investment. This increase in the investment is the growth of the investment.

A best investment decision is that decision which ensures safety, liquidity and growth of investment.

Diversification as a risk mitigation tool

Inflation: It refers to the rise in general price level in the country over a period of time. During the period of inflation, there is an increase of the money supply. It causes the currency to lose its purchasing power which leads to an increase in the price of goods and services.

Effect of Inflation: Inflation affects different people differently. When price rises or the value of money falls, some groups of society gain, some lose and some stand in between. Let’s discuss the effect of inflation:

1. **Effect of Inflation on Business Community:** Inflation is welcomed by entrepreneurs and businessmen as they get profit by rising prices. They find that the value of their inventories and stock of goods is rising in money terms. They also find that prices are rising faster than the cost of production, so that their profit is greatly enhanced.

2. **Fixed Income Groups:** Inflation hits wage-earners and salaried people very hard. Since wage do not rise at the same rate and at the same time as the general price level, the cost of living index rises and the real income of the wage earner decreases.
3. **Farmers:** Farmers usually gains during inflation, because they can get better prices for their harvest during inflation.
4. **Investors:** People those who invest in debentures and fixed income securities, bonds etc lose during inflation. However, investors in equities benefits because more dividend is yielded on account of high profit made by joint-stock companies during inflation.

Indicators of Measure of Inflation are Whole-sale price index (WPI) and Consumer price index (CPI).

WPI (Whole-sale price index): reflects average price changes of goods that are bought and sold in the wholesale market. WPI in India is published by the Office of Economic Adviser, Ministry of Commerce and Industry. Further, the data for WPI is monitored and updated on a weekly basis taking into account all the 676 items that form the index. The various commodities taken into consideration for computing the WPI can be categorized into primary article, fuel and power, and manufactured goods. Primary articles included for the computation of WPI include food articles, non-food articles and minerals. In the fuel and power, light and lubricants, electricity, coal mining and mineral oil are included. The manufactured goods category encompasses food products; beverages, tobacco, and tobacco products; wood and wood products, textiles; paper and paper products; basic metals and alloys; rubber and rubber products and many others. An, important point to take note of this is the whole sale price index (WPI) does not includes the cost of services. Further, as WPI accounts for changes in general price level of goods at wholesale level, it fails to communicate actual burden borne by the end consumer. WPI is the primary measure that is used by the Central government for ascertaining inflation as WPI in contrast to CPI accounts for changes in price at an early distribution stage.

CPI(Consumer price index): is computed by executing a weighted average on a particular set of goods and services. The computation of CPI takes into account price changes and the actual inflation that affects the end consumer. CPI is thus a reflection of changes in the retail prices of specified goods and services over a time period which is traded by particular consumer group.

While earlier the Reserve Bank of India used WPI inflation to manage monetary policy expectations, it is now the CPI inflation which is largely taken into account. The RBI highlights its inflation expectations based on the CPI inflation data that comes in. For example, it sets targets on CPI Inflation and monitors it accordingly. Many analysts for long had suggested that the RBI should move to the CPI data Vs the WPI data, which had now happened in the last couple of years.

For the common man it is always better to keep retail inflation which is the CPI or the Consumer Price Inflation number in mind. It is a better measurement of what is largely happening with consumer prices. WPI inflation on the other hand is better known to individuals who track the wholesale prices and is of better significance to them. In any case both are a measure of inflation.

How Inflation affect our investment:

If we have surplus money we need to invest it in a profitable investment. If we want to invest our money then we have to see whether our rate of return on investment is higher than the rate of inflation or not. If the rate of return on investment is higher than rate of inflation than this investment will be called as profitable investment or if the rate of return on investment is lower than the rate of inflation than this investment will not be profitable. It will be further clear by the following example:

Let's see at what price did you buy your school bag last time? Will you get it for the same price today? The answer is probably no. This means the price of things keep on increasing. This phenomenon of price rise is called Inflation. Now let us assume, the price of your school bag was Rs.200 last year and it costs Rs.210 this year, the inflation rate therefore is 5% (=10/200 *100= 5%). Now if you had saved Rs.200 last year and expected to buy the bag this year with your saving you would be short of Rs.10. Therefore, if you have invested Rs.100 at the rate of 10% and the inflation is 5%, then you have actually earned only 5%. (10%- 5% = 5%). This 5% is your real rate of return.

Real rate of Return:

When savings are invested at a rate which is higher than the inflation rate, then we earn some money in return in real sense. This is called real rate of return. For example: If we invest Rs.100 at the rate of 10% and the inflation is 5%, then you have actually earned only 5%. (10%- 5% = 5%). This 5% is your real rate of return.

Time Value of Money:

Understanding of time value of money is very important in investment, as if we start investing at an early age and keep that money invested for long period of time then we will get good money in return.

Let us understand with the example of Uday and Rajesh. They both entered the job market at the age of 23. Uday decides to keep aside 25,000 every year from the age of 25 until he turned 30, that is, for a period of five years. After 30, he did not touch his investment that is he neither added nor withdrew anything from his capital till he turned 60.Rajesh, on the other hand decided to start saving only when he turned 35. From then till he turned 65, that is, for the next 30 years, he kept aside 25,000 every year.

Guess who saved more?

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

Understanding Interest:

Simple Interest and Compound Interest

Interest is the charge against the use of money by the borrower. The same is profit earned by the lender of money. The amount which is invested in a bank in order to earn interest is called principal. The interest rate is normally expressed in percentage. Simple interest and compound interest are the two types of interest based on the way they are calculated.

Simple Interest:

Simple Interest is charged only on the principal amount. The following formula can be used to calculate simple interest.

Simple Interest (Is) = $P \times I \times T$

Where, P is the Principal amount.

I is the interest per period.

T is the time for which money is borrowed or lent.

Example:

Suppose Rs. 1,000 invested 1st January 2010, 10% simple interest rate for 5 years. Calculate the total simple interest on the amount.

Solution:

We have,

Principal P= Rs.1,000

Interest Rate i= 10% per year.

Time t= 5 years

Simple interest is Rs. 1,000x0.1x5=Rs.500

Compound Interest:

Compound interest is charged on the principal plus any interest accrued till the point of time at which interest is being calculated. In other words, Compound interest system work as under:

1. Interest for the first period charged on the principal amount.
2. For the second period, it is charged on the sum of the principal amount and interest charged during the first period.
3. For the third period, it is charged on the sum of principal amount and interest charged during the first and the second period and so on…

It can be proved mathematically, that the interest as per above procedure is given by the following formula:

Compound Interest (Ic) = $P \times (1 + i)$ n – P

Where,

P is the principal amount.

I is the compound interest rate per period.

n are the number of the periods

Example 2

Consider the same information as given in example 1. Now calculate the total compound interest on the amount invested.

Solution:

We have,

Principal P = Rs. 1,000

Interest rate i = 10% per year.

Number of periods n= 5

Compound interest I= Rs. 1,000x (1+0.1)^5 – Rs.1,000

= Rs.1,000x1.1^5 – Rs.1,000

= Rs.1,000x1.61051 – Rs.1,000

= Rs.1610.51 – Rs.1,000= Rs.610.51.

Nominal Interest and Effective Interest rate:

Interest rates for saving and investment products are quoted either as nominal rates (NACM) or annual effective rates (NACA). The nominal rate is the actual interest earned over a month month period. The annual effective rate is the effective interest rate earned if you were to keep your investment(at the same nominal rate) for one year, hence the name "annual effective". You will therefore earn interest on the capital portion plus on the interest already earned- the beauty of compound interest. That is why an effective rate will always be more than a nominal rate.

Suppose you invest Rs. 1,000 at a nominal interest rate of 5%. Compounded monthly, the calculation for the first month's interest would be 4.17 (1000*5%/12). Now in the second month, you will earn interest on Rs. 1004.17. Therefore, the second month interest will be 4.18 (1004.17*5%/12). We can see that the amount of interest will increase every month, since the nominal interest is paid on the principal amount as well as all interest earned until then. By the end of the year, you would have earned Rs. 51.16 interest, which is Rs. 1.16 more than the interest would be if the nominal interest was compounded yearly.

Rule of 72

Rule says that Divide the number 72 with the rate of interest and witness the magical number which states number of years for your capital to double. Rule of 72 Example: For instance-1: Suppose Mr. Shah meets bank representative to get latest fixed deposit schemes. Mr. Shah uncover that best bank offer is 10% annual interest; let's see how many years it takes to double your investment capital with rule – 72. Formula says that Divide 72 by 10 (i.e. rate of interest) You will get result as where, your invested capital can be doubled in 7.2 years.

Rule of 144

Rule 144 is similar to Rule 72 in all ways only thing which makes it unique is that, Rule 144 will assist you to identify time duration required to quadruple your capital investment evaluated by compounding interest formula. Rule says divide 144 by interest rate to get the years essential to triple your money. Rule of 144 Example: For instance-1: Mr. Rahul read in one of the financial magazine that, country's GDP is growing with the average rate of 7% every year. Formula says that Divide 144 by 7 (i.e. rate of interest) As a result, It will take roughly around 20.6 years to quadruple country's GDP. For instance-2: Mrs. Renu repays its education loan at 12% per annum. Using formula (divide 144 by 12) As a result, approximately within 12 years Mrs. Renu will repay quadruple amount towards education loan.

INVESTMENTS : THE WIDER SPECTRUM

Different products and asset classes for investment:

Where to invest the surplus? This is a very critical decision which an investor has to take. Let us critically analyse the various options available for investment:

Buying a house would be an attractive option as it would ensure roof and value would appreciate over a period of time. However, the disadvantage erupts when the person is transferred to other place, the house would be an inflexible investment .

Investment in gold too would be limiting the choice since it may turn out to be an illiquid investment.

Selling gold may not give a lucrative return.

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

It would be optimum for us to opt for mix of investment in different assets. We can make small investment in a house, a proportion in gold and some amount may be invested in bank deposit and mutual fund to ensure liquidity and higher flexibility.

Information regarding investment in different assets:

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

National Saving Certificate: NSCs are bonds issued by the central government with tenure of six years and sold through post office. Individuals including minors and trusts can invest in

NSCs. They are issued in denominations ranging from 100 to 10,000. They offer interest rate of 8% compounded half yearly. The accumulated amount is paid on maturity.

Mutual Funds: Investors who desire to invest their funds in corporate securities lack information regarding profile of companies. Such investors can invest their funds in corporate securities through mutual funds. The pooled funds are invested by expert portfolio managers. They help the clients to invest in SIPs. Since mutual funds allow investment in numerous stocks, it enables investors to achieve broad diversification with an investment as low as Rs. 500. A mutual fund can generate a capital gain for individual investors since the price at which investors sell their shares can be higher than the price at which they purchase their shares. However, the price of the mutual fund share may decline over time, which would result in a capital loss.

Fixed Deposit: One of the oldest investment avenues in India is bank fixed deposit. It gives a return of 6%-8% p.a. depending on the tenure. It is a safe investment device for those who do not have a risk appetite and have traditionally put their money in them.

Insurance: It is an investment-cum-risk management instrument. The objective of ensuring one's life is to provide financial security to oneself and to the family members.

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

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

Gold: It lends stability to the portfolio and acts as a hedge against inflation .

Understand Mutual Fund:

It offers good investment opportunities to the investors. It also carries certain risk. The investor should compare risks and expected yields after adjustments of tax on various investments while taking investment decision. It is a mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with objectives as disclosed in offer documents.

Investment in securities are spread across a wide cross section of industries and sectors and thus the risk is reduced. Diversification reduces risk because all stocks may not move in the same direction in the same proportion at the same time. Mutual fund issues units to the investors in accordance with quantum of money invested by them. Investors of mutual funds are known as unit holders.

The profits or losses are shared by the investors in proportion to their investments. The mutual funds normally come out with a number of schemes with different investment objectives which are launched from time to time. A mutual fund is required to be registered with Securities and Exchange Board of India (SEBI) which regulates securities markets before it can collect funds from the public.

Different Types of Mutual Funds:

Classification according to maturity period:

Open-ended Fund / Scheme:

An open-ended fund or scheme is one that is available for subscription and repurchase on a continuous basis. These schemes do not have a fixed maturity period. Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices which are declared on a daily basis. The key feature of open-end schemes is liquidity.

Close-ended Fund/ Scheme

A close-ended fund or scheme has a stipulated maturity period e.g. 5-7 years. The fund is open for subscription only during a specified period at the time of launch of the scheme. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where the units are listed. In order to provide an exit route to the investors, some closed-ended funds give an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices. SEBI Regulations stipulate that at least one of the two exit routes is provided to the investor i.e. either repurchase facility or through listing on stock exchanges. These mutual funds schemes disclose NAV generally on weekly basis.

Classification according to investment objectives:

Growth / Equity Oriented Scheme

The aim of growth funds is to provide capital appreciation over the medium to long- term. Such schemes normally invest a major part of their corpus in equities. Such funds have comparatively high risks. These schemes provide different options to the investors like dividend option, capital appreciation, etc. and the investors may choose an option depending on their preferences. The investors must indicate the option in the application form. The mutual funds also allow the investors to change the options at a later date.

Income / Debt Oriented Scheme

The aim of income funds is to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures, Government securities and money market instruments. Such funds are less risky compared to equity schemes. These funds are not affected because of fluctuations in equity markets. However, opportunities of capital appreciation are also limited in such funds. The NAVs of such funds are affected because of change in interest rates in the country. If the interest rates fall, NAVs of such funds are likely to increase in the short run and vice versa. However, long term investors may not bother about these fluctuations.

Balanced Fund

The aim of balanced funds is to provide both growth and regular income as such schemes invest both in equities and fixed income securities in the proportion indicated in their offer documents. These are appropriate for investors looking for moderate growth. They generally invest 40-60% in equity and debt instruments. These funds are also affected because of fluctuations in share prices in the stock markets. However, NAVs of such funds are likely to be less volatile compared to pure equity funds.

Money Market or Liquid Fund

These funds are also income funds and their aim is to provide easy liquidity, preservation of capital and moderate income. These schemes invest exclusively in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money, government securities, etc. Returns on these schemes fluctuate much as compared to other funds. These funds are appropriate for corporate and individual investors as a means to park their surplus funds for short periods.

NAV (Net Assets Value):

The performance of a particular scheme of a mutual fund is expressed by NAV. Mutual fund invest the money collected from the investors in securities market. NAV is the market value of securities held by the schemes. NAV per unit is the market value of securities of a scheme divided by the total number of units of the schemes on any particular date.

NAV is the total asset value (net of expenses) per unit of the fund and is calculated by the Asset Management Company (AMC) at the end of every business day. Net asset value on a particular date reflects the realisable value that the investor will get for each unit that he is holding if the scheme is liquidated on that date.

The value of all the securities in mutual funds portfolio is calculated daily. From this, all expenses are deducted and the resultant value divided by the number of units in the fund is the fund NAV or its Net Asset Value.

Entry Load and Exit Load:

Some Asset Management Companies (AMCs) have sales charges, or loads, on their funds (entry load and/or exit load) to compensate for distribution costs. Funds that can be purchased without a sales charge are called no-load funds. Entry load is charged at the time an investor purchases the units of a scheme. The entry load percentage is added to the prevailing NAV at the time of allotment of units. Exit load is charged at the time of redeeming (or transferring an investment between schemes). The exit load percentage is deducted from the NAV at the time of redemption (or transfer between schemes). This amount goes to the Asset Management Company and not into the pool of funds of the scheme.

Public Provident Fund:

- PPF interest rate is now **8.65%**.
- Minimum deposit is 500/- per annum. Maximum deposit is Rs. 1,50,000/- per annum
- The scheme is for 15 years.
- Investment up to Rs 1,50,000/- per annum qualifies for Income Tax Rebate under section 80C of IT Act.
- Interest is completely tax-free.
- Deposits can be made in lump sum or in 12 instalments.
- One deposit with a minimum amount of Rs 500/- is mandatory in each financial year.
- Withdrawal is permissible from 6th financial year.
- Loan facility available from 3rd financial year upto 5th financial year.
- Free from court attachment.
- Non-Resident Indians (NRIs) not eligible.
- An individual cannot invest on behalf of HUF (Hindu Undivided Family) or Association of persons.
- Ideal investment option for both salaried as well as self employed classes.

National Saving Certificate:

National saving certificate scheme is a scheme launched by the government to promote the habit of savings among the common man and to channelize these saving in the right direction for the benefit of whole country. Under this scheme deposits are accepted by the government through post office and amount generated through these deposits is used for the growth of the country.

To encourage the tax payer to invest in this scheme, the government has allowed this investment in NSC to be claimed as a tax deduction under section 80C which helps the tax payers in reducing his tax burden.

Interest

The interest rate in NSC is almost at par with interest rates on other fixed income earning instruments like PPF, Tax saving fixed deposit etc. The interest rate on NSC is compounded half yearly and is announced by the government every year before 1st April and they keep on changing every year.

Interest on NSC is liable to tax as per the income tax slab of the individual. However no TDS is deducted on such interest but such income shall be reflected in the income tax return of the individual.

Minimum and Maximum

The minimum amount to be invested in NSC is Rs.100 and there is no maximum limit on the amount to be invested in the NSC. A person can invest any amount in NSC. However, tax deduction under section 80C can only be claimed for a maximum of Rs. 1,50,000.

Types of NSC

Single holder type certificate

Joint A type certificate

Joint B type certificate.

Post Office Monthly Income Scheme:

Post Office Monthly Income Scheme is one of the post office schemes which gives you a guaranteed return on your investment. Anyone who wants to generate a monthly income can open this account and get an assured monthly income.You get interest per year, which is payable on per month basis. You will get the interest each month from *the date of making the investment,* not from start of the month.

This post office saving scheme does not come under sec 80C so there is no tax-exemption for the amount you invest in this, and interest income is taxable, but there is no TDS cut in this scheme.

The maturity period of this scheme is 6 years. You will also be eligible for a 5% bonus if you retain your scheme for 6 years, so eventually your overall return including this bonus can turn out to be around 8.9%. There is a limit on the amount you can invest in POMIS. It’s limited to Rs 4.5 lacs for a single account and 9 lacs for a joint account. You can have any number of accounts, but within the overall upper limit. Even though the maturity period for POMIS is 6 yrs , there is facility to break it and take your money out. However you can take your money only after 1 year. You have to pay some penalty which is as follows

- **If you break it within 1-3 yrs** : 2% penalty on Deposit amount
- **If you break it after 3 yrs** : 1% penalty on Deposit amount

Ponzi Schemes:

A Ponzi scheme is a fraudulent investing scam promising high rates of return with little risk to investors. The Ponzi scheme generates returns for older investors by acquiring new investors. This scam actually yields the promised returns to earlier investors, as long as there are more new investors. These schemes usually collapse on themselves when the new investments stop.

Functions of SEBI:

The SEBI performs functions to meet its objectives. To meet three objectives SEBI has three important functions. These are:

i. Protective functions ii. Developmental functions iii. Regulatory functions.

1. Protective Functions:

These functions are performed by SEBI to protect the interest of investor and provide safety of investment.

As protective functions SEBI performs following functions:

(i) It Checks Price Rigging:

Price rigging refers to manipulating the prices of securities with the main objective of inflating or depressing the market price of securities. SEBI prohibits such practice because this can defraud and cheat the investors.

(ii) It Prohibits Insider trading:

Insider is any person connected with the company such as directors, promoters etc. These insiders have sensitive information which affects the prices of the securities. This information is not available to people at large but the insiders get this privileged information by working inside the company and if they use this information to make profit, then it is known as insider trading, e.g., the directors of a company may know that company will issue Bonus shares to its shareholders at the end of year and they purchase shares from market to make profit with bonus issue. This is known as insider trading. SEBI keeps a strict check when insiders are buying securities of the company and takes strict action on insider trading.

(iii) SEBI prohibits fraudulent and Unfair Trade Practices:

SEBI does not allow the companies to make misleading statements which are likely to induce the sale or purchase of securities by any other person.

(iv) SEBI undertakes steps to educate investors so that they are able to evaluate the securities of various companies and select the most profitable securities.

(v) SEBI promotes fair practices and code of conduct in security market by taking following steps:

(a) SEBI has issued guidelines to protect the interest of debenture-holders wherein companies cannot change terms in midterm.

(b) SEBI is empowered to investigate cases of insider trading and has provisions for stiff fine and imprisonment.

(c) SEBI has stopped the practice of making preferential allotment of shares unrelated to market prices.

2. Developmental Functions:

These functions are performed by the SEBI to promote and develop activities in stock exchange and increase the business in stock exchange. Under developmental categories following functions are performed by SEBI:

(i) SEBI promotes training of intermediaries of the securities market.

(ii) SEBI tries to promote activities of stock exchange by adopting flexible and adoptable approach in following way:

(a) SEBI has permitted internet trading through registered stock brokers.

(b) SEBI has made underwriting optional to reduce the cost of issue.

(c) Even initial public offer of primary market is permitted through stock exchange.

3. Regulatory Functions:

These functions are performed by SEBI to regulate the business in stock exchange. To regulate the activities of stock exchange following functions are performed:

(i) SEBI has framed rules and regulations and a code of conduct to regulate the intermediaries such as merchant bankers, brokers, underwriters, etc.

(ii) These intermediaries have been brought under the regulatory purview and private placement has been made more restrictive.

(iii) SEBI registers and regulates the working of stock brokers, sub-brokers, share transfer agents, trustees, merchant bankers and all those who are associated with stock exchange in any manner.

(iv) SEBI registers and regulates the working of mutual funds etc.

(v) SEBI regulates takeover of the companies.

(vi) SEBI conducts inquiries and audit of stock exchanges.

Government Schemes

Pradhan Mantri Jan Dhan Yojana

This financial inclusion programme was launched by Government of India on 28/08/2014.

It is run by Finance ministry of India.

Under this scheme 15 million bank account were opened on inauguration day.

There is a record of most bank account opened in one week as a part of financial inclusion is 1,80,96,130 and was achieved by Government of India from 23rd to 29th August, 2014. The Guinness Book of World Records recognizes this achievement.

Till 27th June, 2018 over 318 million Bank Account were opened.

Pradhan Mantri Suraksha Bima Yojana

It is a government backed accident insurance scheme in India.

It was launched by Government of India on 8th May, 2015.

It is available to people between 18 and 70 years of age with bank account.

The GST is exempted on Pradhan Mantri Suraksha Bima Yojana.

In case of accidental death or full disability, the payment to the nominee will be Rs. 2 lakh and in case of partial permanent disability Rs. 1 lakh.

Deaths due to suicide, alcohol, drug abuse, etc, are not covered in this scheme.

Pradhan Mantri Jeevan Jyoti Bima Yojana

It is a government-backed Life insurance scheme in India.

It was formally launched by Prime Minister Narendra Modi on 9 May in Kolkata. As of May 2015, only 20% of India's population has any kind of insurance, this scheme aims to increase the number.

Till 31 March 2019, 5.91 crore people have already enrolled for this scheme. 1,35,212 claims have been disbursed amounting to a total of ₹2,704.24 crore

The premium is deducted automatically from the insured's bank account. Insured's family members will receive a sum insured of 2 lac Rupees after insured's death.

Atal Pension Yojana:

Atal Pension Yojana is a government-backed pension scheme in India, primarily targeted at the unorganised sector. It was launched by Prime Minister Narendra Modi on 9 May in Kolkata.

The minimum eligible age for a person joining APY is 18 years and the maximum is 40 years.

An enrolled person would start receiving pension on attaining the age of 60 years. Therefore, a minimum period of contribution by the subscriber under APY would be 20 years or more.

Subscribers are required to opt for a monthly pension from ₹1,000 (US$14) to ₹5,000 (US$70) and ensure payment of the stipulated contribution regularly (monthly, quarterly, or half-yearly basis). Subscribers can opt to decrease or increase pension amount during the course of the accumulation phase.

Sukanya Samriddhi Account (*Girl Child Prosperity Account*)

It is a Government of India backed saving scheme targeted at the parents of girl children. The scheme encourages parents to build a fund for the future education and marriage expenses for their female child.

The scheme was launched by Prime Minister Narendra Modi on 22 January 2015 as a part of the Beti Bachao, Beti Padhao campaign.

The scheme currently provides an interest rate of 8.4%[3] (for July-September 2019 quarter) and tax benefits. The account can be opened at any India Post office or branch of authorised commercial banks.

The account can be opened anytime between the birth of a girl child and the time she attains 10 years age by the parent/guardian.

The girl can operate her account after she reaches the age of 10. The account allows 50% withdrawal at the age of 18 for higher education purposes. The account reaches maturity after time period of 21 years from date of opening it.

MUDRA Loans

The MUDRA loan is provided under the Pradhan Mantri MUDRA Yojana (PMMY) to non-farming and non-corporate micro and small enterprises. These enterprises can avail loans up to Rs.10 Lakh under the MUDRA (Micro Units Development & Refinance Agency Ltd.) scheme.

Features of the Pradhan Mantri Mudra Loan:

Loan Amount	Maximum loan amount Rs. 10 lakh - Loan of upto Rs. 50,000 under Shishu - Loan from Rs. 50,001 to Rs. 500,000 under Kishore - Loan from Rs. 500,001 to Rs.10,00,000 under Tarun
Processing fee	Nil for Shishu and Kishore loan, 0.5% of the loan amount for Tarun loan
Eligibility Criteria	New and existing units

Repayment period	3 –5 years

Pradhan Mantri Vaya Vandana Yojana (PMVVY)

It is a Pension Scheme announced by the Government of India exclusively for the senior citizens aged 60 years and above which is available from 4th May, 2017 to 31st March, 2020.

Scheme provides an assured return of 8% p.a. payable monthly (equivalent to 8.30% p.a. effective) for 10 years.

The scheme is exempted from Service Tax/ GST.

The scheme also allows for premature exit for the treatment of any critical/ terminal illness of self or spouse. On such premature exit, 98% of the Purchase Price shall be refunded.

On death of the pensioner during the policy term of 10 years, the Purchase Price shall be paid to the beneficiary.

Loan upto 75% of Purchase Price shall be allowed after 3 policy years

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