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Money Simplified

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Retirement Planning & YOU

Evaluating the best options

>> Equities

>> Pension

>> Mutual Funds

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Preface

Money Simplified

Retirement Planning & YOU

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Retirement Planning ranks as one of the most overlooked financial planning activities. Most of us are so preoccupied with planning and providing for the present that we overlook the need to provide for the future. The need to plan for retirement is real. And it is important that it is given top priority.

In this issue of the Money Simplified we guide you through the entire process of retirement planning. To start with we take up a case study of a young professional who wishes to plan for his retirement. We also evaluate investment avenues that are available for the purpose and suggest some options for a retirement portfolio.

At Personal*fn* we regularly meet individuals who wish to plan for retirement. Most of them are young professionals who have just started off with their careers. Indeed, that is the right time to start planning for retirement; the longer the time to retirement, the lesser you need to save (the power of compounding works for you).

At times we meet individuals who are about to retire or are already us retired. In such instances, one hopes that the client had come to us a lot earlier as it becomes impossible to plan for a post-retirement income that is in line with the present standard of living of the individual. In this guide, we also discuss some investment options for these individuals.

We are sure this guide will get you started on your retirement planning. And in case you have already started, we are certain that with the help of this issue of Money Simplified, you will be able to plan a lot smarter!

Happy reading!

Team Personal*fn*
2nd January, 2006

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Why should you plan for retirement?

The only way we have to answer that question is by countering with another one – why shouldn't you plan for retirement? We contemplated writing an article on '5 reasons individuals need *not* plan for retirement' but failed to come up with even one good reason. Of course, we did not consider reasons like 'lottery winnings' or 'millionaire father's legacy'. On the flipside, there are several important reasons that we came up with on why individuals should definitely plan for retirement.

If you want even a vague idea on why retirement planning is important, try speaking to your father or a senior citizen from your family/acquaintances and ask him about his 'financial' regrets. Our bet is that the first one will be – 'I wish I had saved more'. We are also willing to bet that the more people you ask, the more you will hear this. Our advice – let this not become a regret for you as well.

Apart from being the sage advice of the elderly, there are some important reasons to plan for retirement. The most important one is inflation, a term most of us are pretty familiar with, but may not have fully appreciated the 'harm' it can do to your money over the long term. Ever wondered why the toothpaste that cost just Rs 8 about 15 years ago, costs more than Rs 50 today or why petrol and LPG cylinder prices have risen by more than 6 times over this period. The reason for such a sharp rise in the prices of these and thousands of other products can be summed up in one word – inflation. Put simply, inflation diminishes the purchasing power of money; so over time you get less for the same amount of money or pay more for the same goods. While we grumble about rising prices of fruits, vegetables, the LPG cylinder and property among other things, at least we are in a position to afford a lot of them while we are able and earning. Will we still be able to pay for them, when we have retired and stopped earning? Anyone who believes he won't have a problem paying for the daily items of consumption should consider this - our research says that given the current rate of inflation, by 2017, Colgate Toothpaste will cost Rs 104 (costs about Rs 47 today), a litre of petrol will cost Rs 259 (Rs 48) and the humble Hamam Soap will not appear humble at Rs 52 (Rs 18)

Inflation leads to a rise in prices of goods and services. From a retirement perspective, rising cost of medical services is significant. At that age, people need more medical attention and as years go by, it becomes a challenge to provide for the rising medical costs. And it's not just your expenses, but that of your spouse as well. As life expectancy increases rising medical costs seem more daunting, especially since you will not have a regular income at that stage. This may seem scary now but if you plan for it, it takes away a lot of uncertainty.

Today, you find a lot of families where children continue to live with their parents as joint families even after marriage. However, if the existing trend towards 'moving out' is any indication, then older people may not really have their children to fall back upon during emergencies. So financial independence becomes even more critical.

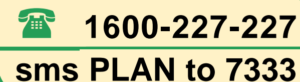
According to a statistic from a leading life insurance company, only a little over 10% of India's working population has any form of social security. That means a lot of people have not planned for their retirement at all, which is very unfortunate. Retirement planning is not just important, but when you get down to it, it's a lot simpler than you had thought it to be. We believe that a little bit of discipline and patience can go a long way in turning 'Retire in peace' from a slogan into reality.

Take pride in giving, even after retirement

HDFC STANDARD LIFE PENSION PLANS

By investing today, you can continue to take care of your family even after retirement. HDFC Standard Life Pension Plans have been devised with various options to suit your needs:

- Option of two plans – 'Personal Pension Plans' & 'Unit Linked Pension Plan'
- Avail tax benefits under Sec 80CCC



Respect Yourself

HDFC Personal Pension Plan Form No. SN07 & HDFC Unit Linked Pension Plan Form No. SN18.
Unit Linked Plans are different from traditional insurance plans & are subject to different risk factors.
In Unit Linked Pension Plan, the investment risk in your chosen investment portfolio is borne by you.
HDFC Standard Life Insurance Co. Ltd. Insurance is the subject matter of the solicitation.

Retirement Planning – A case study

Before we get on with discussing the case study, it is important to highlight that retirement planning is

1. a very personalised process that is unique to every individual.
2. an ongoing process because what we are aiming at is not fixed (our standard of living, which we are aiming to secure will change over time)

Our aim therefore in discussing this case study is to understand how you can get started in planning for your retirement. For you to be able to draw up a personalised retirement plan, you will require the services of a financial planner.

In this note, we will discuss the retirement planning process of an individual, say Ajay. Ajay is 30 years of age; he is married and has a two year old child. He is a professional, employed in a software services company. He draws a compensation of Rs 30,000 per month. His wife too is employed, as a teacher. She draws a salary of Rs 15,000 pm. The present household expenditure is Rs 30,000 pm. Ajay is looking to retire at age 58 years.

Since we are focusing on retirement planning for Ajay and his wife, we need to look at the cost they incur in maintaining their present standard of living. Let's assume, Ajay wants to, as of today, maintain the same standard of living post retirement i.e. he will need Rs 30,000 per month (pm), adjusted for inflation, on retirement. Therefore, we have to plan Ajay's investments in a manner that they will yield an income of Rs 30,000 pm, 28 years from now.

Post retirement, other than regular monthly expenditure Ajay will incur expenditure on travel and healthcare. Given that health costs are rising fast and we are traveling more for leisure, it is prudent to set aside some money for these purposes. We have assumed Ajay will require Rs 500,000 per annum (pa) post retirement (Rs 125,000 pa in today's Rupee terms after adjusting for inflation).

Another head of information that will be required is Ajay's present savings and the rate at which they are expected to grow over the years. These savings could include balances with the Employee Provident Fund (EPF), mutual funds, savings-based life insurance policies and fixed deposits among others. The house that Ajay owns and lives in will not be added to his existing assets for the purpose of retirement planning. This is because he lives in the house and will not be able to generate income by way of rent or sale of property at the time of retirement.

Finally, before we get down to the numbers, we will need to make two assumptions :

1. the average rate of inflation for the next 28 years
2. the low risk rate of return you can earn 28 years from now; at 58 years of age your risk appetite will be low and therefore a bulk of your investments will be in very low risk securities that yield regular income

While it is difficult to say with certainty what the actual inflation and rate of interest will be, we nevertheless need to have a starting point. In our view, an average inflation rate of 5% pa is a reasonable estimate. As far as the rate of return is concerned 28 years down the line, we think it will be about 5% pa.

It is important to restate at this point that retirement planning is not a one time exercise. As your standard of living changes and the investment environment evolves, you will need to regularly make adjustments to your plan so that you can achieve your objective. Therefore, these assumptions too will change over time and Ajay will need to accordingly make adjustments to his saving and investment pattern. It should be understood that Ajay's financial advisor will have an important role to play in the reassessment.

Let's now take a look at the retirement planning solution for Ajay (see table).

Solution for Retirement Planning

		Case 1 Aggressive	Case 2 Moderate	Case 3 Small Savings
Current Monthly Expenditure	Rs	30,000	30,000	30,000
Time to retirement	yrs	28	28	28
Expected inflation per year	%	5	5	5
Monthly Expenditure - at retirement age	Rs	117,604	117,604	117,604
Annual Expenditure at ret. Age	Rs	1,411,246	1,411,246	1,411,246
Incl for travel, healthcare	Rs	500,000	500,000	500,000
Annual expenditure at retirement	Rs	**1,911,246**	**1,911,246**	**1,911,246**
Expected Annual Return - at retirement	%	5	5	5
Therefore, to cover exp., corpus reqd.	**Rs**	**38,224,930**	**38,224,930**	**38,224,930**
Your existing assets	**Rs**	**250,000**	**250,000**	**250,000**
Existing assets will grow at...	**%**	**15**	**12**	**8**
Value of existing corpus at retirement	**Rs**	**12,516,403**	**5,970,967**	**2,156,777**
Therefore, net to be accumulated	**Rs**	**25,708,527**	**32,253,963**	**36,068,153**
Solution		Case 1	Case 2	Case 3
Contribution		Aggressive	Moderate	Small Savings
Corpus to be accumulated	Rs	25,708,527	32,253,963	36,068,153
Assumed Return	%	15%	12%	8 %
Tenure (Years)	yrs	28	28	28
Annual Saving Reqd	Rs	78,594	169,136	378,315
Or simply, Monthly investment of	Rs	6,138	13,374	30,426
Or a one-time investment of	Rs	513,497	1,350,450	4,180,794

Case Study

We have taken three scenarios depending on the profile of the client. The third solution (Small Savings) has been included to show how any retirement portfolio that is almost entirely focused on investing in schemes like EPF, NSC and post office is likely to perform over time.

The methodology we have adopted is that Ajay will aim to accumulate a corpus which when invested in low risk securities on retirement will yield the desired income. So, the Rs 30,000 pm now is equivalent to about Rs 117,600 twenty-eight years from now (post-inflation). To earn this income (Rs 117,600 pm) at a return level of 5%, the amount that is required to be invested is about Rs 38.2 m (Rs 3.82 crores).

In Case 1, we discuss a scenario where Ajay is 'aggressive' while making his investments i.e. he takes on high risk with the hope of earning higher returns over the tenure of investment. A 15% pa compounded return is what we have assumed in this case. If the money is invested in instruments which can yield such a return, then Ajay will have to either make a one-time investment of Rs 513,500, or a monthly investment of Rs 6,100 throughout the tenure. In Case 2, the only difference is that the assumed return on investments is lower at 12%; so the investment required to meet the objective is higher at about Rs 1,350,000 (one-time) or Rs 13,400 (monthly).

Case 3 is not really an option but something what a lot of investors are unconsciously opting for. A lot of their savings are in such schemes despite the fact that returns have declined sharply over the years. While the returns are attractive, from a long-term perspective of 28 years they do not compare well with the other options (like equities).

This is apparent from the table where a portfolio comprising predominantly of post-office schemes is a poor performer as compared to a portfolio that comprises other riskier assets. Ofcourse, returns offered by small savings schemes are guaranteed; but at the same time in case of PPF and EPF they are reset every year i.e. the return is not fixed. Moreover, at the time of maturity, it is likely that the return offered by such schemes will be lower than what it is today. Therefore the rate at which the money is rolled over will be lower, reducing the overall returns. Having said that, such schemes should form a small part of any long term portfolio, on the basis of their highest level of safety.

Once Ajay has a fix on the amount he wishes to set aside to meet his retirement needs, he will need to identify exactly which assets to invest in. If he is opting for an aggressive portfolio, he will have to decide which stocks/equity funds/ ULIPs to invest in. Some ideas are discussed in this guide; we recommend that you finalise your portfolio only after discussions with your financial planner.

As is evident from the table, retirement planning is a relatively simple exercise that requires investing discipline and, regular monitoring. It is important to make a start; however small it may be.

Early Start

The importance of starting early!

An often-heard excuse for putting off retirement planning is "I have enough time to go before I retire, so why rush?". Sadly, most fail to realise that procrastination is their biggest adversary when it comes to making retirement plans. In fact, starting early and ensuring that you have sufficient time on your side is the key to successful retirement planning. In this article we will discuss how making an early start can be advantageous in more ways than one and also the pitfalls of not making an early start.

Greater flexibility

Having adequate time grants a degree of flexibility to your retirement plans. It gives you the opportunity to explore various investment options and avenues. For example, among asset classes, equities are known to outperform others like gold, property and bonds over longer time frames. The key is "longer time frames". However, over shorter time periods equities can be the most volatile asset class. Hence if you wish to gainfully utilise the power of equities, making an early start is imperative.

Power of compounding

The single biggest advantage which can be derived from making an early start is the opportunity to benefit from the power of compounding. Put simply, this is the ability of an asset to generate returns, which are reinvested for generating more returns. Longer time horizons enhance the compounding benefits. An illustration will help us better understand the same.

Mr. Raj and Mr. Jai (both 30 years of age), wish to make investments to build a corpus for their retirement. Mr. Raj starts immediately with annual investments of Rs 10,000 earning a return of 8% pa. On the other hand, Mr. Jai procrastinates and starts investing after 10 years. However to make up for the lost time, he invests twice the amount i.e. Rs 20,000 at 8% pa. Both the individuals would like to retire at the age of 60 years, giving Mr. Raj an investment horizon of 30 years, while the same is 20 years for Mr. Jai.

	Mr. Raj	Mr. Jai
Amount invested (Rs per annum)	10,000	20,000
Tenure of investment (years)	30	20
Returns (% per annum)	8	8
Maturity amount (Rs)	1,132,832	915,239

At 60 years of age, Mr. Raj has a corpus of Rs 1,132,832 as compared to Rs 915,239 accumulated by Mr. Jai. Despite doubling the investment amount, Mr. Jai fails to match the sum amassed by Mr. Raj. The longer investment tenure (30 years vis-à-vis 20 years) makes all the difference. The message is clear – give your investments sufficient time to grow and you can gain from the power of compounding.

For those who come in late

Those who delay their retirement-related investments are likely to have a tough time in meeting their defined objectives.

Suppose you decide (after taking into account your present income and expenses, the likely increase in both) that on retirement you will need a corpus of Rs 2,500,000. We will assume that investments made will yield a return of 12% per annum. Now let us consider 3 scenarios, wherein you are 30 years, 20 years and 10 years away from retirement.

	Case 1	Case 2	Case 3
Target amount (Rs)	2,500,000	2,500,000	2,500,000
Tenure (years)	30	20	10
Returns (%)	12	12	12
Annual investment (Rs)	10,359	34,697	142,460
Monthly investment (Rs)	819	2,744	11,265

In case 1, the monthly investment amounts to approximately Rs 819; however with passage of time, it grows exponentially. As a result if you start investing for retirement, 20 years before the due date, Rs 2,744 will be the monthly investment amount. Finally in case 3, when there are 10 years left for retirement, the monthly investment required will be Rs 11,265.

With lesser time at your disposal, a higher amount has to be set aside for meeting your retirement needs. Not only can the same be tough on the wallet, for some it may not be a feasible option. As a result, the pre-determined investment objective might have to be toned down. Moral of the story – Not only does it pay to start early, delaying the same can cost you dear!

We have discussed how it helps to start early and how not starting early could prove to be an expensive proposition. But there is also a need to understand why many fail to get started.

At times individuals are not able to set aside the requisite amount of money needed for their retirement. They can contribute only a part of it, not all. As a result, they end up postponing their plans. In our view, this is a wrong approach. Instead, the right course of action is to start off with what you have and make up for the deficit at a later stage. On the other hand, if you decide to simply wait for an 'opportune' time, it might be too late by the time you start.

Another reason is that a significant amount of money is often spent on providing for one's present lifestyle i.e. shopping and entertainment binges, leaving very little for retirement. While the importance of satisfying present needs cannot be denied, it does make imminent sense to take care of your future as well. You should strive to strike a balance between the two.

Finally, perhaps, making a retirement plan and putting money aside for the same acts as a reminder of the eventuality – retirement. Maybe the thought of growing old and leading a rather sedentary lifestyle brings with it a certain degree of discomfort and discourages some from working towards their retirement plan

However such a mindset needs to change. Looking the other way will only worsen the situation. The solution lies in accepting retirement as an eventuality and being adequately prepared for it. And making an early start is your best bet at being prepared!

Pension Plans – The way to go

Pension plans offered by life insurance companies help individuals plan effectively for their retirement. For it is pension plans which provide individuals with a regular income in their golden years. However, since the tax benefit on such plans is limited to Rs 10,000, investments in such plans have been somewhat subdued. Apart from the tax benefits, it is important that individuals evaluate pension plans from a retirement planning perspective. This article takes a closer look at pension plans and the role they play in the individual's retirement planning exercise.

Simply put, pension plans (also referred to as retirement plans) are offered by insurance companies to help individuals build a retirement corpus. On maturity this corpus is invested for generating a regular income stream, which is referred to as pension or annuity. Pension plans are distinct from life insurance plans, which are taken to cover risk in case of an unfortunate event.

Let us take an individual aged 30 years who, wants to buy a pension plan with a sum assured of Rs 500,000 for a 30-Yr tenure. The premium to be paid for the same is approximately Rs 13,500. In case of an eventuality, the beneficiary will stand to get the sum assured of Rs 500,000 plus the bonuses/additions, if any. In case the individual survives the tenure, he will stand to benefit to the tune of the maturity amount as indicated in the table below. Assuming that he buys an annuity for life, the annual amount he would get as pension would be approximately Rs 71,500 (on Rs 960,000) or Rs 118,500 (on Rs 1,590,500). The option of receiving monthly/ quarterly/half-yearly pension is available with most life insurance companies.

However, the returns shown at 6% and 10% are not calculated on the premium paid. They are calculated after deducting expenses from the premium. The actual compounded annual growth rate (CAGR) on the premium works out to approximately 5.10% (for the 6% figure) or 7.80% (for the 10% figure).

Pension Plan Illustration

Age (Yrs)	Sum Assured (Rs)	Tenure (Yrs)	Annual Premium (Rs)	Maturity Amt (@6%) (Rs)	Maturity Amt (@10%) (Rs)
30	500,000	30	13,500	960,000	1,590,500
			Actual rate of return	5.10	7.80
			Annuity amount	71,500	118,500

The example given above is illustrative. It will differ across insurance companies.

Conventional pension plans invest a major portion of the premium monies in bonds and government securities (gsecs). That is why the returns are on the lower side. And if one were to factor

Regular Pension Plans: A comparative study

	ICICI Prudential (ForeverLife)	Tata AIG (Nirvana)	Bajaj Allianz (Swarna Vishranti)	LIC (Jeevan Suraksha/ Jeevan Dhara)	HDFC Personal Pension Plan
Minimum premium pa (Rs)	6,000	N A	5,000	2,500	2,400
Minimum cover (Rs)	50,000	50,000	50,000	50,000	N A
Min-Max. tenure (Yrs)	5-30	N A	5- 40	2- 35	10-40
Min/Max Age at entry (Yrs)	20-60	18-55	18-65	18-65 (for Jeevan Dhara); 18-70 (for Jeevan Suraksha)	18-60
Min-Max vesting age (Yrs)	50-70	50-65	45-70	50-79	50-70
Riders	Critical illness, Accident and disability benefit	Term rider, Critical illness, Accident	Term cover, Critical illness cover, Hospital cash benefit, Accident benefit, Family income benefit	Term cover, Critical illness	
Life cover	Yes	-	Yes	Yes	-

The information in the table is as sourced from companies' websites. Individuals are advised to contact the insurance company for further details. Fixed monthly expenses for some companies are subject to inflation-based indexation and may change in future. Companies reserve the right to change their policies anytime in the future.

into the equation an annual inflation figure of approximately 5%-6% per annum, then the real return figures look even more unimpressive.

This is where unit linked insurance plans (ULIPs) can play an important role in the retirement planning exercise. ULIPs have a mandate to also invest a portion of the premium in the stock market aparrt from bonds and gsecs. Studies have shown that from a long term perspective, equities are equipped to give a higher return vis-à-vis other fixed income instruments like bonds and gsecs. And since retirement planning is a long-term exercise, individuals would do well to consider investing a portion of their retirement money in pension ULIPs.

Having said that, it is also important that investments in ULIPs are made after considering expenses like fund management charges since this will impact returns over the long term. Also, don't lose sight of your overall equity allocation. For example, if the individual

Pension ULIPs: A comparative study

	ICICI Prudential (Lifetime Pension II)	HDFC Standard Life (Unit Linked Pension Plan)	Birla Sun Life (Flexi SecureLife II)	LIC (Future Plus)	Bajaj Allianz (Unit Gain easy Pension)
Product type	Market linked plan	Market linked plan	Market linked plan	Market linked plan	Market linked plan
ULIP fund options	Pension Maximiser II (Growth), Pension Balancer II (Balanced), Pension Protector II (Income), Preserver	Growth fund, Equity-managed fund, Balanced fund, Defensive fund Secure fund, Liquid fund	Nourish, Growth, Enrich	Bond fund, Income fund, Balanced fund, Growth fund	Equity index pension fund, Equity plus pension fund, Equity MidCap plus pension fund, Debt plus pension fund, Balanced plus pension fund, Cash plus pension fund
Allocation to equities	Upto 100% in pension maximiser-II; upto 40% in pension balancer-II; nil in Protector II & Preserver	100% in growth fund; 60-100% in equity-managed fund; 30-60% in balanced fund; 15-30% in defensive managed fund; nil in secure managed & liquid fund	Upto 35% in Enrich; upto 20% in Growth; upto 10% in Enrich	Bond fund: NIL; Income fund: Not more than 20%; Balanced fund: Not more than 30%; Growth fund: Not more than 60%	Equity index pension fund: at least 85% in stocks primarily from NSE Nifty Index; Equity plus pension fund: at least 85%; Equity MidCap plus pension fund: at least 50% in midcap stocks; Debt plus pension fund: NIL; Balanced plus pension fund: 30%-50% in equity index fund and 50%-70% in debt plus fund; Cash plus pension fund: NIL
Minimum premium (Rs)	10,000	10,000	5,000	5,000	10,000
Life cover option available	Yes	No	Yes	Yes	No
How is Sum assured calculated	Option 1: Zero sum assured. Pure accumulation Option 2: Sum assured = annual contribution X tenure.	Sum assured = Rs 1,000 plus the fund value.	10 times the regular premium amount.	5-20 times the annualised premium.	Zero sum assured. Pure accumulation.
Min/Max Age at entry (Yrs)	Option 1: 18-65 Option 2: 18-60	18-60	18-65	18-65	18-65

continued.....

	ICICI Prudential (Lifetime Pension II)	HDFC Standard Life (Unit Linked Pension Plan)	Birla Sun Life (Flexi SecureLife II)	LIC (Future Plus)	Bajaj Allianz (Unit Gain easy Pension)
Min-Max vesting age (Yrs)	45-75	50-70	50-70	40-75	45-70
Initial years' expenses	17%-22% in first yr. 12%-15% for second yr. (Exact percentage depends upon the annual premium amt)	8.50%-22% for years 1 and 2. (Exact percentage depends upon the annual premium amt)	21% for the first year	8%-13% for years 1 and 2 (Exact percentage depends upon the premium amt)*	15% for the first year
Fund management charges	Maximiser II- 1.5%; balancer-1.0%; protector II & preserver-0.75%	0.80%	1%	Bond fund and Income fund: 1%; Balanced fund: 1.25%; Growth fund: 1.50%	Equity MidCap plus and Equity plus pension funds: 1.5%; Equity index pension fund: 1%; Debt plus pension fund and Cash plus pension fund: 0.70%; Balanced plus pension fund: As applicable on component funds
Expenses after initial years (%)	1% for years 3 to 10. Nil thereafter.	1% third year onwards.	2.2% second year onwards.	2.50%	2% second year onwards
Fixed monthly expenses (Rs)	20	15	35 (Additional charge of Rs 2 levied in case life insurance cover opted for)	15	20
Charges on top-ups (%)	1% of top-up value for first 10 yrs. Nil thereafter.	2.5% for initial two years. 1% thereafter.	1%	1.25%	2%
Switch charges	4 free switches in a year. Rs 100 per switch thereafter.	5 free switches. Thereafter 2.00% of switched amt maybe charged.	2 free switches in a year. 0.50% of the amt transferred thereafter.	4 free switches in a year. Rs100 per switch thereafter.	3 free switches in a year. 1.00% of switched amt or Rs 100, whichever is higher thereafter.

Apart from the expenses mentioned above, LIC's Future plus also charges for the following: (1) Life cover charge (as applicable) (2) Administration charge: Rs 1 per thousand of sum assured subject to a max. of Rs 1,000 in each of the first 2 yrs. (3) Policy charge: Rs 0.10 per thousand in each of the first 2 yrs (in case of life cover); Rs 0.10 per thousand of the total premiums payable in each of the first 2 yrs.

has already invested a significant amount of his money in stocks and equity funds, then he might be better off investing in a conventional pension plan from a diversification perspective.

ULIPs other important benefits like liquidity. You can withdraw money from a ULIP to meet emergencies. Also, you can invest surplus money (i.e. top ups) over and above the premium amount.

Some insurers have launched capital guarantee ULIPs. Such products aim to guarantee the premiums paid by the individuals (net of expenses) plus the bonus declared, on maturity. Individuals, who fear 'loss of capital' in a ULIP, will find such products attractive. However, capital guarantee ULIPs have lower equity exposure which could dampen returns for the aggressive investor.

'With cover' and 'without cover' plans

Pension plans are also classified as 'with cover' and without cover' plans. The 'with cover' pension plans offer an assured life cover (i.e. sum assured) in case of an eventuality. Under the 'without cover' pension plan, the corpus built till date (net of deductions like expenses and premiums unpaid) is given out to the nominees in case of an eventuality. There is no sum assured in this case.

'Immediate annuity' plans and 'Deferred annuity' plans

Pension plans are also classified as 'immediate annuity' plans and 'deferred annuity' plans. In case of immediate annuity plans, the annuity/pension commences within one year of having paid the premium (which is usually a one-time premium). The premium paid for the immediate annuity policy is also known as the purchase price. Presently in India, very few life insurance companies offer immediate annuity plans. LIC's Jeevan Akshay II is an example of an immediate annuity pension plan.

In case of deferred annuity, the annuity/ pension does not commence immediately; it is 'deferred' upto a time, which is decided upon by the policy holder. For example, if an individual buys a pension plan with tenure of 30 years (also known as the 'deferment period'), then his annuity will begin 30 years hence. Deferred annuity premiums can be paid as a 'single premium' or as regular premium. Presently, most pension plans available are deferred annuity plans.

Difference between conventional life insurance plans and pension plans

There are some fundamental differences between life insurance plans and pension plans, with the objective behind both of them, being the most important. Life insurance plans aim at covering the risk from an unfortunate event. Pension plans on the other hand work on the opposite scenario that if an individual survives beyond an age (retirement age), he will need to provide for himself. The difference in objectives is the main reason for the differences in the features of life insurance and pension plans.

1. Maturity payouts

In case of conventional insurance plans,

Spot the difference

	Conventional Insurance Plans	Pension Plans
Maturity payouts	Full maturity amount received by the individual	Only upto one-third of the maturity amt can be withdrawn. Remaining 2/3rd amount has to be compulsorily invested in an annuity.
Death benefits	Full maturity amount received by the nominees/ beneficiaries	Nominees/ beneficiaries have the option of receiving either the entire maturity amount or invest in an annuity.
Tax benefits	Deduction upto Rs 100,000 available under Section 80C	Deduction upto Rs 10,000 available under Section 80CCC.
Taxation of maturity payouts	Entire maturity amt treated as tax free in the hands of the receiver	Upto 1/3rd of the maturity amount, if withdrawn, is treated as tax-free. Pension received on the remaining 2/3rd amt is taxed as per the individual's tax slab
Stream of income	Entire maturity amt/ death benefit received in one go. No provision for a stream of income by way of pension.	On maturity, provides for a regular income stream. In case of an eventuality, option option of pension benefits available

the individual receives the entire corpus on maturity. However, in case of pension plans, the individual has the option of withdrawing upto one third of the maturity amount in cash. He will have to buy an annuity with (at least) the remaining two thirds amount from any life insurer of his choice.

2. Death benefits

In case of an eventuality under life insurance plans, the nominees receive the sum assured plus the bonuses/ additions if any. Not all pension plans offer a life cover (as already covered above). Also, in case of a pension plan, the nominee has the option of receiving the entire amount on maturity in cash and buying an annuity with the same.

3. Tax benefits

Premium paid upto Rs 100,000 per annum is eligible for deduction under Section 80C in case of insurance plans. However, premium payments towards pension plans are eligible for deduction under Section 80CCC; the limit being set at Rs 10,000. However, the deduction under Section 80CCC falls under the overall limit of Rs 100,000. For example, if an individual pays a premium of Rs 15,000 for a pension plan, then the tax benefit of Rs 10,000 only. Also, his overall tax benefit will stand reduced to Rs 90,000 (i.e. Rs 100,000 less Rs 10,000).

4. Taxation of maturity payouts

The maturity amount in case of

conventional insurance plans is treated as tax free in the hands of the individual. However, it is slightly different in case of pension plans. Upto one third of the maturity amount, which can be withdrawn, is treated as tax free in the hands of the individual. The pension, from the remaining two-thirds amount, is taxed according to the marginal rate of tax.

5. Income stream

On maturity, pension plans provide a regular source of income by way of annuities. In case of conventional plans, the individual receives the entire maturity amount in lump sum.

Options available to individuals on pension plans

Pension plans come with various annuity options. We have explained them below:

1. Lifetime annuity without return of purchase price: Under this option, the individual receives pension for as long as he lives. The pension ceases on occurrence of an eventuality and the insurance contract comes to an end.

2. Annuity for life with a return of the purchase price: If this option is exercised, the individual receives pension till he is alive. In the event of an eventuality, the purchase price of the annuity is paid out to his nominees/ beneficiaries. Purchase price here means the maturity amount, which includes the basic sum assured plus the bonuses/ additions, if any.

3. Lifetime annuity guaranteed for a certain number of years: Under this option, the individual receives a pension for a certain number of years (as prescribed by the plan) irrespective of whether he is alive for the said period or not. A major positive of this option is that, if he survives the period, he continues to receive pension for the rest of his life.

For example, if the individual has opted for 'Lifetime annuity guaranteed for 15 years', and he meets with an eventuality after only 3 years, then his nominees will keep receiving annuity for the remaining 12 years (i.e. 15 years less 3 years). After the said 15-Yr period, the annuity will cease and the pension plan will draw to a close.

4. Joint life/ Last survivor annuity: The individual receives a pension till he is alive. In case of an eventuality, his spouse receives the pension.

Apart from the options mentioned above, some companies also offer both, 'with' and 'without return of purchase price'. Under the 'Joint life / last survivor annuity with return of purchase price', in case of an eventuality to both the individual as well as his spouse, the purchase price of the annuity is 'returned' to the nominee.

Evidently, pension plans help individuals prepare for their retirement needs. Not only do they aid in building a corpus over a period of time, but they also provide income for life. That is why it is important that individuals include pension plans while conducting their retirement planning exercise.

Life insurance and retirement planning

Life insurance plans form an essential part of any financial planning exercise. The same holds true while planning for retirement. The good news is that there are various insurance policies that help individuals plan for retirement. This article explains how individuals can, with the help of life insurance, prepare themselves for the golden years of life.

Table 1: Term plans: High on value, low on cost!

	HDFC Standard Life (Term Assurance)			ICICI Prudential (Life Guard)			LIC (Anmol Jeevan I)			SBI Life (Shield)			Kotak Mahindra Old Mutual (Preferred Term plan)		
Tenure	*20*	*25*	*30*	*20*	*25*	*30*	*20*	*25*	*30*	*20*	*25*	*30*	*20*	*25*	*30*
Age 25	2,720	2,770	2,820	2,933	2,933	3,064	2,544	2,861	NA	1,954	2,180	NA	2,424	2,535	2,755
Age 35	3,580	4,120	4,750	3,798	4,067	4,564	4,613	5,534	NA	3,542	4,375	NA	3,747	4,188	4,739
Age 45	7,620	NA	NA	8,258	NA	NA	NA	NA	NA	8,354	NA	NA	7,797	8,970	NA

Source: Personal*fn* Research

The premiums given in the table are for a sum assured of Rs 1,000,000 for a healthy, non-smoking male. Taxes as applicable may be levied on some premium quotes given above. The premium quotes given above are only indicative. Individuals are advised to contact the insurance companies for further details.

Simply put, the purpose of life insurance is to indemnify the nominees/ dependants of the insured against an eventuality. There are two kinds of insurance plans, which fulfil this purpose i.e. savings-based plans (endowment/endowment type plans/ ULIPs) and term plans. Let us begin with term plans and the role they play in the retirement planning exercise.

Term plans

A term plan is what is generally termed as 'pure risk insurance'. In such plans there is no savings component, and hence they are very affordable (a 30 yr old healthy male could get a Rs 1 m cover for 30 years for just Rs 4,000 pa!). The benefits accrue to the nominee in case of an eventuality to the policyholder. Naturally, there are no maturity benefits in case the insured survives the tenure.

A term plan plays an essential part in retirement planning. It helps the individual to focus on the retirement planning exercise without having to worry about the 'financial condition' of his nominees/dependants in his absence. It does this by providing for a large sum assured at a lower cost, which can help take care of finances in the absence of the breadwinner. One can also opt for add-on riders with the basic term plan policy. A term plan is particularly useful in case the individual has bought a pension plan from a life insurance company 'without life cover'.

Ideally, a term plan should be bought by an individual for the maximum tenure available. The maximum tenure available as well as the premium charged differs across insurance companies. Individuals would do well to check these aspects before finalising on such plans (refer Table 1).

The earlier a term plan is bought, the cheaper it turns out to be. Having said that, it is never too late to buy a term plan.

Savings-based plans

These plans differ from term insurance in one primary aspect - they also provide for a maturity amount if the individual survives the tenure of the plan. That is because the premiums charged by such plans also include a savings element. The savings portion is invested by the life insurance company to generate returns, which the individual receives on maturity.

Savings-based insurance plans play an important role in the retirement planning exercise. They help individuals build a corpus for retirement. This becomes necessary keeping in mind that individuals would have stopped working at that age and a regular income stream like salary won't be available. On the other hand, the retiree will continue to incur regular expenses. Other important factors like inflation and higher medical expenses would also have to be factored into the equation.

Various kinds of insurance plans are available to help individuals build a nest egg for retirement. Pension plans and regular endowment plans fall in this category. Let us take a look at regular endowment plans (pension plans have been dealt with separately in this guide). An illustration will help in understanding this point.

Suppose an individual aged 30 years, insures himself for a sum of Rs 500,000 for a 30-year tenure. As can be seen from the table, the premium he will pay for the same is about Rs 12,500. In case of an eventuality, the nominees will get the sum assured i.e. Rs 500,000 plus the additions/bonuses (if any) till date. In case the individual survives the tenure, he stands to get Rs 791,000 (calculated @ 6% compounded annual growth rate-CAGR) Rs 1,610,000 (calculated @10% CAGR) on maturity.

Table 2: Endowment plan illustration

	Age (Yrs)	Sum Assured (Rs)	Annual Premium (Rs)	Tenure (Yrs)	Maturity Amount 6%	Maturity Amount 10%
Company A	30	500,000	12,500	30	791,000	1,610,000
Company B	30	500,000	14,000	30	960,000	1,590,000

The figures given above are indicative. They will vary across life insurance companies.

However, it must be understood that the return figures are really not as impressive as they are made out to be. Returns are not calculated on the actual

premium paid. Instead, they are computed on the premium after deducting expenses. In the illustration (refer Table 2), the actual return on premium works out to approximately 4.45% CAGR (for the 6% return figure) and 6.26% (for the 10% figure) respectively.

and traditional endowment plans is their investment mandate and flexibility. ULIPs have a mandate to invest premiums (upto 100%) in varying proportions in equities or in debt. Individuals also have the freedom to shift their monies from equity to debt and vice-versa in varying proportions.

Table 3: ULIPs versus traditional insurance

	ULIP	Traditional endowment plans
Sum assured	As a multiple of the premium	Known upfront, premium is based on it
Investments	Allocation to equities, bonds, gsecs, money market depending on the option	Larger allocation to bonds, gsecs, money market, smaller equity allocation
Expenses	Lower agent commissions	Higher agent commissions
Flexibility	High	Low
Transparency	High	Low
Liquidity	High	Low
Tax benefits	Available	Available

The figures will differ across insurance companies. Individuals need to evaluate their options before they finalise on an insurance company. For example, as is apparent from Table 2, in case of Company B, the actual return is different as compared to Company A (4.91% CAGR for the 6% return calculations and 7.61% CAGR for the 10% return calculations respectively). The return declared by a life insurance company depends on how well it manages its finances and controls expenses.

Conventional endowment plans invest premiums in bonds and government securities which is why the returns are so subdued. This is where unit linked insurance plans (ULIPs) can help.
The primary difference between ULIPs

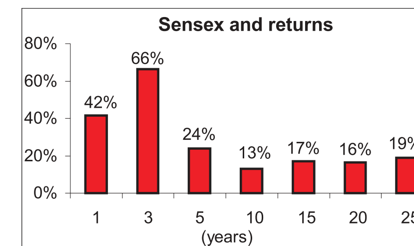
We believe that ULIPs (powered by equities) are equipped to offer better returns over the long term. And since retirement planning is a long-term activity, investing in ULIPs would hold individuals in good stead. However, individuals should note that investments in ULIPs should be in line with their risk profile and their overall asset allocation.

Clearly, life insurance is an important tool for any individual planning for retirement. However, as we have highlighted, this exercise must be conducted after assessing one's investment objective and needs. This will ensure you are not caught wrong-footed in your golden years.

Retirement planning and stocks

In the long term, we all are dead, said John Maynard Keynes. But this is not a very good reason for not planning for your retirement! While the context of this article is going to revolve around why one should 'also' invest in equities for retirement planning, this has got nothing to do with the bull market now!

This is important to consider because the magnitude of returns that one has witnessed in the last three years is not likely to be repeated every year. And aligning return expectations to one's risk appetite is very important while conducting the retirement planning exercise.



Why equities?

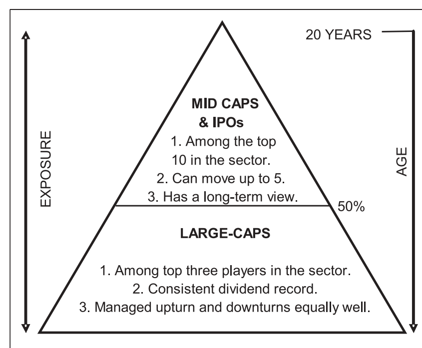
Now, coming back to how equities can help you in your retirement planning exercise, here is a graph that highlights the returns on Indian equities (represented broadly by the BSE Sensex). As is evident, the returns in the last three years have been 66% CAGR. But if one takes a look at returns over a 10-Yr period, the rates are more realistic and trace the Indian nominal GDP growth rates. However, it has to be mentioned that between February 1992 to July 2003, the BSE Sensex, on a point-to-point basis, was at the same level! While it has not been a one-way ride, what the graph highlights is that equities can provide decent inflation-adjusted returns in the long term. And since retirement planning is a long-term activity, equities can be rewarding in nature.

How equities?

With 'why equities?' cleared, now comes the critical question of 'how equities?' Conventional investment wisdom tells you that 'as age increases, the risk appetite decreases'. And given the fact that equities are a high-risk asset class, the proportion of equity exposure in the overall portfolio should reduce with an increase in age. But how much exposure should one have to equities is a function of your age and your goals (short-term and long-term). 'Your Asset Allocator Review' (or 'YAAR' as we call it at Personalfn), answers the 'How equities?' question with a pre-designed portfolio mix for various ages. The portfolio suggests how much equity exposure a person should have at various stages in conjunction with other asset classes.

At a younger age, in the equity portfolio, one can have greater weightage to high-risk stocks/sectors and as one's age increases, the weightage of low-risk stocks/sectors should increase. In equities, we suggest investors to have a mix of direct and indirect participating. Direct would involve buying a stock

from the primary (IPOs) and secondary market (stock market), while indirect involves investing through the mutual funds route.



Which equities?

This is the trickiest question to answer! To simplify this process for investors, we have listed various sectors based on our assessment of risks from a long-term perspective. Of course, sector identification is one part; the more important aspect is to choose the right stock(s) from the sector. Key aspects while investing in equities:

1. Invest in a company whose business you understand.
2. In the long-term, stock prices trace earnings growth and also, the company's ability to generate free cash flow. While there can be volatility in the interim period (both in stock prices as well as the financial performance of the company), if one has the confidence that a company can go the distance, invest.
3. While mid-cap and small-cap companies can be exciting, it is always judicious to have a mix of both these categories.
4. If one does not have the time, leave it to the experts you trust viz. mutual funds and portfolio management services.
5. Lastly and most importantly, a bull market or a bear market does not change the fact that equities are a risky asset class. Do not blame the market for your losses.

CRYSTAL GAZING...

Low risk	High risk	Medium risk
FMCG	Steel	Banking
Housing Finance	Software	Telecom
Cement	Indian Pharma	Power
Paints	Auto	Fertilisers
Engineering	Shipping	Media
MNC Pharma	Energy	
	Hotels	
	Textiles	
	Retailing	

Given the fact that the value of money reduces over time, it is important to generate adequate returns to sustain the desired standard of living, even after retirement. In our view, adequate and careful investing in stocks is one way to achieve this goal (of course, with the extra risk). As someone said "Life begins at retirement".

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Marrying mutual funds to retirement planning

Any investor with a long-term investment plan for retirement cannot give equities a miss. And any investor who plans to invest in equities cannot give mutual funds a miss. That is why mutual funds have a critical role to play in your retirement planning portfolio.

Mutual funds and retirement planning have enough points in common to make them perfect for each other. Consider this – retirement planning is about investing for the long- term, at times for even longer than 35 years. Mutual funds (equity-oriented funds to be more precise) are also about investing for the long-term. This is because equities as an asset class are best equipped to 'deliver' results over the long-term. Over the short-term they can be extremely volatile and may even erode your retirement savings. There is little doubt that equity funds can help you achieve your investment goals. But for that to happen, you need to be invested for the long-term; at least 10 years in our view from a retirement planning perspective.

If you are saving for retirement by taking the equities route you will need advice; and we mean advice from experts and not tipsters, brokers, television channels or magazines for most of whom long-term means the next hour, next day or next week. When you have money in equities you need someone to constantly monitor the stock markets, the economy, interest rates and various domestic and global factors that are likely to have an impact on your investments. Given the enormity of the task it is easy to appreciate why managing equities is a full-time job. This is where mutual funds come in. Mutual funds usually have investment teams that seek investment opportunities in the stock markets on a full-time basis. This is something that as an investor you may attempt to do on your own, but may never have enough time or capability for given your personal and work commitments.

Having highlighted the benefits of long-term investing in equities, we would like to draw your attention to another critical aspect of retirement planning, i.e. asset allocation. Asset allocation is very important when you are deciding on your retirement portfolio. We have seen instances where stock market slumps have lasted for over 20 years. During that period, investors with above-average allocation to stocks witnessed significant erosion in their portfolios. On the other hand, investors who had diversified their assets across avenues like bonds, gold, property and cash, managed to stay afloat and in some cases even clock reasonable returns. That is what asset allocation is all about; it allows investors to benefit from a well-diversified portfolio that helps them exploit opportunities and cut losses across ups and downs in the various asset markets.

Despite the relatively smaller domestic mutual fund industry, you can be sure that selecting the best mutual fund schemes for retirement is a challenge.

There are several reasons for that – for one the industry has too many schemes within each category with little separating one from the other. And second, there are too many unscrupulous agents trying to milk their commissions out of unsuspecting investors by talking about the most irrelevant, but high commission paying, schemes. The irrelevance is even starker, when you consider the schemes from a retirement perspective.

So what is the best way to identify the mutual funds that must find their way to your portfolio? To be sure, there are ways to spot the right mutual funds; and the good news is that with a little bit of homework and some help from your qualified investment advisor you can be as good as anyone else at it.

1) Systems

Pick up any business daily today and the one headline that is likely to hit you is about a fund manager leaving an AMC (Asset Management Company). If you are invested in that mutual fund then the first question that will come to your mind is – what should I do now? You are not alone; we get a barrage of emails and calls from investors when a star fund manager leaves his job to join the next mutual fund, or these days, a hedge fund. In some cases, it's downright unfair to the investor when he invests in a 'new fund offer' (NFO) because of a star fund manager, only to find the news of his departure being leaked once the NFO period is over.

Our advice to you – don't get married to your fund manager. Instead pick an AMC based on its investment processes and systems and not its star fund manager. Process-driven AMCs adopt a team approach (as opposed to an individualistic approach), which tends to de-risk the exit of an individual leaving the team. When you are selecting a mutual fund make sure that it has well-defined investment processes that can function well even in the absence of a particular fund manager. We do not expect investors to have access to this information as easily as we make it out to be; that is where your investment advisor/mutual fund agent comes in. Ask him about the processes and systems adopted by various AMCs. If his advice is based on solid research and not commissions then he should be able to answer a lot of your questions on this topic.

2) Track record

Once you have identified an AMC with well-defined investment processes, you should check its track record. Typically, equity fund performances must be monitored over at least three years in our view and from a retirement viewpoint, over 10 years. Some times you have a relatively new AMC like Fidelity Fund Management for instance, (with an established track record in other markets) that can't be gauged on the minimum 3-Yr track record. In such a scenario it makes sense to dig a little deeper and find out what its achieved in other markets, its systems and processes and what kind of experience they have in managing domestic stocks. Even for

mutual funds with longer track records, it is important to consider how it fared during a market downturn, which is what separates a good fund from an average one.

Once you have identified an AMC for its team-based investment approach, look for some signs that show its approach works. The most obvious place to verify this is in the performance. An AMC with systems in place is likely to have its funds perform in a typical manner. For instance, if an AMC has a process that ensures its equity funds are very well-diversified in terms of stocks and sectors, then these funds will counter a market downturn much better than their concentrated peers. Also over a period of time, there will be a degree of consistency in the performance of the AMC's equity funds.

While evaluating an AMC's equity schemes it is important to consider the volatility and risk-return parameters. Well-managed equity funds tend to have lower volatility which is reflected in lower Standard Deviation numbers over time. Likewise, they have higher risk-adjusted returns, which is reflected by higher Sharpe Ratios.

3) Go for funds with well-established track records; avoid NFOs

When you look at the domestic mutual fund landscape you see too many funds that have little relevance from a retirement planning viewpoint. A lot of them are thematic funds that, to begin with, do not have much of a track record. Moreover, when you are planning for retirement over a 20-30 year period, it is best to ignore themes and go for funds that invest across stocks and sectors without any bias. We believe that over the long-term, thematic fund performances are likely to be more erratic than consistent. There will come a time when the theme will have run its course leaving the fund manager with a truncated list of investment options. That is why it is best to invest in an equity fund that targets 'capital appreciation' - plain and simple, and not 'capital appreciation through opportunities in outsourcing/capital goods/infrastructure/consumerism'. Remember if theses themes really merit investment then even the conventional equity fund manager is likely to invest in them. But the advantage he has is that he can exit the theme once it loses steam, unlike the thematic fund manager who has to remain invested in adherence to his investment mandate.

Another thing to avoid is NFOs, not that we have anything against them, but a lot of NFOs that are being launched presently are of the thematic fund variety. If there is an NFO of the 'conventional' variety, then we would recommend you evaluate it on the first two parameters.

Our preferred AMCs

Having researched mutual funds for more than eight years, our mutual fund research team has grown to prefer some AMCs over others. Their performance, track record and processes are the main attributes that caught our eye. Of course,

that is not to say that others do not have them; it's just that we have short-listed the three that we like the most.

1) HDFC Asset Management Company
HDFC Asset Management Company is a joint venture between HDFC (50.1% stake in HDFC AMC) and Standard Life Investments of UK (49.9%). It was launched in September 2000. While its performance took a while to kick off, there was no mistaking its well-defined investment processes and systems. Today, it has some of the better performing funds across the diversified equity, tax-saving, balanced and monthly income plan (MIP) segments. Contrary to popular perception, its best funds are a mix of the erstwhile Zurich India Mutual Fund (which it took over in 2003) as also funds launched by it since 2000. The fund's team-based investment approach is apparent from the fact that even with a star fund manager like Mr. Prashant Jain in its midst, there are several other equity fund managers managing various funds that compare well with their peers.

2) Franklin Templeton Investments
Launched in 1996, Franklin Templeton Investments is among the more well-established names in the mutual fund business. It acquired Pioneer ITI in 2002 and became one of the leading fund houses in the country with some of the best equity funds and an experienced and proficient equity fund management team. The fund house pursues a team-based, process-driven investment approach, something that came to their rescue when their Chief Investment Officer – Debt quit last year.

3) Sundaram Asset Management Company
Sundaram Asset Management Company is among the more conservatively run AMCs in the country. A pointer to this fact is that its funds rarely feature in the rankings; it is equally true that they rarely disappoint investors. As a matter of fact, over the years investors have come to expect a certain degree of consistency and stability in their performance. Like with the other AMCs we like, Sundaram Mutual Fund has a team-based system in place. Recently BNP Paribas acquired 49.9% stake in Sundaram Asset Management Company, thereby bringing down the Sundaram Group stake to 50.1%. Our interaction with the AMC indicates that this is unlikely to have an impact on the fund management style of Sundaram Mutual Fund's schemes.

Time to look beyond EPF & PPF

Retirement planning has rarely been actively practiced in the Indian context. The system of joint families is partly responsible for the same. Retirees were provided for by their children and family members, thereby eliminating the need to plan for one's retired life. For others who didn't have the luxury of falling back on their family, savings schemes like EPF (Employees' Provident Fund) and PPF (Public Provident Fund), emerged as the default choices. Attractive returns offered by these schemes ensured that a sizeable corpus was available on retirement. As a result most individuals never felt the need to give retirement planning a serious thought. In the changing scenario, however, such a passive attitude towards retirement planning may become untenable.

The usual suspects
Before discussing the new investment environment, let us examine the schemes under question. EPF is a statutory contribution deducted from employees' salaries. The amount deducted is matched by the employer with an equal contribution. Employees' contribution to EPF is eligible for deduction under Section 80C of the Income Tax Act and at present earns a tax-free return of 8.50%. PPF on the other hand, falls in the category of small savings schemes and is open for investors across categories. Investments upto Rs 70,000 per annum are eligible for deduction under Section 80C. The scheme runs over a 15-Yr time frame and presently offers returns at 8.00%. Interest earnings from both EPF and PPF are tax-free on maturity.

With such attractive options available, do investors even need to bother exploring alternative avenues? We think so and rationalisation in the aforementioned schemes should be credited as the primary reason. Returns on schemes like EPF and PPF are divorced from market rates; factors other than economics often play a vital role in their determination.

At the time of writing this report, the 10-Yr benchmark GOI paper yielded a return of 7.11%. In simple words if you were to invest in the given instrument and hold it till maturity, it would deliver a taxable return of 7.11%. EPF and PPF offer higher returns and that too tax-free! This is indicative of the disparity in market-linked returns vis-à-vis those offered by EPF and PPF. As a result their feasibility and sustainability over longer time frames (for which they are intended) needs to be questioned.

Rationalisation in progress
Authorities on their part have initiated a host of measures to rationalise schemes like EPF and PPF, and align their returns with market rates. In January 2000, EPF offered a return of 11.00%; similarly investments in PPF yielded a return of 12.00%. At present PPF investments earn a return of 8.00%. The recommended rate on EPF deposits has recently been

reduced from 9.50% to 8.50% for the year 2005-06.

Interest rates on EPF and PPF are reset every year; as a result, investors' returns are assured but not fixed. An investor, who invests in PPF at 8.00% now, might earn just 6.00% a few years hence. This is distinct from avenues like National Savings Certificate (NSC), wherein the earnings rate is locked at the time of making investment. The investor in NSC continues to earn returns at the stipulated rate (irrespective of any subsequent changes in the rate) throughout the tenure of investment.

Tax sops on these investments have also added to their allure. However the same could be short-lived. The Finance Minister while presenting the Budget 2005-06 had proposed adopting the EET method of taxation for tax-saving instruments instead of the EEE method. Under the EEE (exempt-exempt-exempt) method, contributions to specified schemes are exempt from tax, accumulation (earnings on investment) is exempt from tax and similarly the withdrawals/benefits from the schemes are exempt as well.

Conversely, under the EET (exempt-exempt-taxed) method, while contributions and accumulations are exempt, the withdrawals/benefits would be taxed. A committee has been set up to work out a roadmap for moving towards the EET system and to examine the instruments that would qualify for the new regime. If EPF and PPF were to be brought under the EET regime, investors' retirement corpuses can shrink on account of the tax liability. This in turn might make their retirement plans go awry.

Another possibility which needs to be considered is the emergence of a dichotomous structure in savings schemes. For example investors in lower income brackets might continue to receive returns at attractive and "divorced" from market rates, while a new toned down structure could be introduced for those in higher income brackets. A precedent of small investors' interests being safeguarded in the aforementioned manner does exist in the Indian context.

For example, in the bailout package for US64 investors, those with less than 5,000 units were given the option of liquidating their investments at a higher net asset value (NAV) as opposed to those with larger holdings.

We believe the rationalisation process in schemes like EPF and PPF is irreversible and the returns delivered by these schemes will only become more aligned with market rates going forward.

What should you do?

Firstly, investors should factor in a scenario wherein schemes like EPF and PPF might be inadequate to provide for their retirement needs. This in turn necessitates that investors explore alternate avenues like mutual funds and pension plans for building a retirement corpus. Mutual funds invest in both equity and debt instruments, and are available in a number of variants; this makes mutual funds a feasible avenue for investors across risk profiles.

For those who are habituated to conventional assured return schemes, the transition to market-linked instruments like mutual funds can be a tough one. However given that "free lunches" like EPF and PPF might soon be a thing of the past (at least for some if not all), investors on their part would do well to gear up for new investment scenario.

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Already retired? Here's a solution!

All through this issue of the Money Simplified, we have dealt with issues pertaining to retirement planning. The implicit assumption was that individuals have time on their side and can use the various strategies for planning and conducting their retirement in a better manner. However there is a segment for which this advice might have come a bit too late – the retirees.

If you are already retired, what you really need is a retirement solution. Let's begin by discussing the uniqueness associated with building a portfolio for retirees.

Firstly, the importance of capital preservation gets magnified manifold. The retirement corpus at the investor's disposal has to provide for him henceforth. Hence high-risk investment avenues like equities or equity funds should either be excluded or be allocated a very modest portion of the portfolio.

Liquidity assumes significant importance. With no alternate options like salary or business income to fall back upon, the portfolio should be structured in such a manner that it grants a high degree of liquidity to the investor.

In this article, we will discuss the various investment options available to retirees and find out how they measure up.

Senior Citizens Savings Scheme (SCSS)

As the name suggests, the scheme is a dedicated investment option for senior citizens i.e. individuals above 60 years of age; those above 55 years are also permitted to invest subject to fulfillment of certain conditions. The minimum investment amount is Rs 1,000 while the upper limit has been capped at Rs 1,500,000.

The scheme runs over a 5-Yr period and offers a return of 9.00% pa on a quarterly basis making it the most attractive investment option in the peer group.

Premature encashment is permitted after completion of 1 year from the deposit date. If the investment is liquidated before expiry of 2 years, an amount equal to 1.50% of the deposit is deducted. A termination after completion of 2 years, attracts a penalty of 1.00% of the amount invested.

Post Office Monthly Income Scheme (POMIS)

Another popular investment avenue for investors seeking regular income, POMIS is operated from post offices and offers assured monthly income. The minimum investment amount is Rs 1,000; the upper limits have been set as Rs 300,000 and Rs 600,000 for single and joint accounts respectively.

The investment tenure for POMIS is 6 years and investments earn a return of 8.00% pa; also a 10.00% bonus is paid on maturity. The norms for premature withdrawal are rather stringent. Withdrawals are permitted after 1 year; however 5.00% of the initial amount invested is deducted. Withdrawal after 3 years is permitted without any deduction.

Post Office Time Deposits (POTD)

POTD is essentially the fixed deposit variant from the small savings segment. While the minimum investment amount is Rs 200, there is no upper limit on investments.

POTD offers investors a number of options in terms of investment tenures ranging from 1 year to 5 years. Similarly, the returns range from 6.25% to 7.50% on a quarterly compounding basis. Interest payments are made annually.

Premature withdrawals can be made after the completion of 6 months; however investors have to bear a loss on interest.

8% Savings (Taxable) Bonds, 2003

These bonds offer an assured return of 8.00% pa over a 6-Yr period. Investors can choose between the cumulative and the half-yearly option. The 8% Savings Bonds fare rather poorly on the liquidity front with no premature encashment permitted. Like its peers above, investments in these bonds are fully taxable.

Fixed Deposits

Retirees can also consider making investments in the monthly income plan of fixed deposits. Such deposit schemes are offered by companies like HDFC Limited. Our preference is for fixed deposits with an 'AAA' rating indicating a high degree of safety. Interest payouts are made every month throughout the tenure of investment. Also fixed deposits are known to offer a higher interest rate (generally 0.50% more than the regular rate) to senior citizens, thereby making them attractive investment options.

Albeit terms and conditions set by the issuer govern premature encashment, it is generally permitted only after completion of 3 months from the date of deposit. Also liquidating the investment before completion of its stipulated tenure entails loss of interest.

All the investment options discussed so far were of the assured return variety. Alongside the fact that some of the returns might seem rather modest when adjusted for inflation, the tax implications will also adversely affect their attractiveness. After the omission of Section 80L, interest income from bonds and fixed deposits among other avenues has become fully taxable.

Monthly Income Plans (MIPs)

Monthly Income Plans typically invest 15%-20% of their corpus in equities and the balance in debt instruments. Investors can choose between the monthly, quarterly, half-yearly and annual dividend options or the growth option. However it should be understood that on account of their market-linked nature, MIPs expose the investor to higher levels of risk vis-à-vis peers like POMIS and POTD. Also the returns are not assured; neither is there certainty in terms of capital preservation.

On a positive note, MIPs are equipped to deliver superior returns as compared

to its assured return peers. Also it scores on the liquidity front as there is no fixed investment tenure (an exit load may be charged if investments are liquidated within 6 months from the investment date). Finally, dividends received from MIPs are tax-free in the investor's hands, albeit a dividend distribution tax has to be borne by the fund house.

The decision to invest in any of the aforementioned schemes and the allocation to each scheme should be a factor of the investor's risk profile. Retirees who are not averse to taking on a higher degree of risk can make more allocation to MIPs or even consider adding diversified equity funds to their portfolios. Conversely, those who attach greater importance to capital preservation should invest predominantly in assured return instruments.

Likewise, the retiree's requirements will also play an important part in the portfolio creation. For example, a retiree who is well off and supported by his family may not need to fend for himself. Instead he might be keen on investing for his grandchildren and other family members. In such a scenario, the investment tenure goes up, as does the opportunity to take on higher risk; equity-oriented funds emerge as a feasible option.

Finally, don't undermine the importance of a qualified and experienced investment advisor. Powered by expert advice and prompt service, a good investment advisor can ensure that your post-retirement investments become a hassle-free affair.

Investment avenues for retires

	8% Savings Bonds	Fixed Deposits	POMIS	POTD	SCSS	MIPs
Tenure (years)	6	3	6	5	5	No fixed tenure
Min. Investment (Rs)	1,000	20,000	1,000	200	1,000	5,000
Max. Investment (Rs)	No limit	No limit	Ind. - 300,000 / Joint - 600,000	No limit	1,500,000	No limit
Safety/Rating	Highest	AAA	Highest	Highest	Highest	Moderate Risk
Interest rate	8.00%	6.75%	8.00%	7.50%*	9.00%	7.00%-9.00%^
Interest payment	Half yearly	Monthly	Monthly	Annually	Quarterly	Monthly^
Tax Benefits (Income)	Nil	Nil	Nil	Nil	Nil	Tax free
On Maturity	Principal	Principal	Principal + 10% bonus	Principal	Principal	Not assured
Amount invested (Rs)	100,000	100,000	100,000	100,000	100,000	100,000
Annual Interest (Rs)	8,000	6,750	8,000	7,714	9,000	7,000-9,000^

*Compounded quarterly
^ Not assured

Source: Personalfn Research

Medical insurance: A blessing in uncertain times

Medical science has advanced by leaps and bounds in the last few decades. It has also brought alongwith it, an increase in the average life expectancy. According to a leading life insurer, 'life expectancy is likely to rise from 77 years to 85 years over the next decade'. In such a scenario, there's a definite need to cover for unforeseen medical expenses during the individual's working years.

This in turn, will ensure that his long-term finances will not take a hit in case of major medical expenses in his latter years. Also with a greater number of individuals moving out of the joint family system, this will ensure that retirees are better equipped to fend for themselves when faced with medical expenses. This is where medical insurance comes to the rescue.

Simply put, medical insurance or 'Mediclaim' as it is more popularly known, helps an individual cover the unforeseen expenses incurred due to injury/hospitalisation. In addition to providing for the expenses, it also covers expenses sustained before as well as after hospitalisation. All this, it does at a very small cost to the individual. An illustration will help in understanding this better.

Medical insurance is a must!

The premium quotes given above are inclusive of service tax and education cess.

The premium quotes are as given on the websites of the respective companies and only indicative. Individuals are advised to contact the insurance company for further details.

	Age (Yrs)	Amount to be insured (Rs)	Annual premium (Rs)
New India Assurance Co.	30	300,000	3,796
ICICI Lombard	30	300,000	3,100

Let us take an individual aged 30 years, wants to cover himself with medical insurance for a sum of Rs 300,000. The annual premium he will have to pay in case he decides to opt for New India Assurance Company is Rs 3,796. Conversely, if he decides to buy 'Mediclaim' from ICICI Lombard, then the premium amount he will have to shell out is Rs 3,100.

In case of hospitalisation, the expenses that are incurred will be taken care of by this policy subject to the limit of the cover. The cover will be to the extent of the sum assured of the policy. This cover will also take care of pre as well as post-hospitalisation expenses like money spent on buying medicines and conducting medical tests. Of course, the reimbursements of expenses are subject to conditions.

While planning for retirement, individuals don't want to be in a situation where they have to face a huge medical bill and haven't planned for it.

Unplanned medical expenditure could compel an individual to dip into his retirement savings thereby disturbing his financial plans.

Medical cover is also available by way of opting for the 'Critical Illness Rider (CI)' alongwith a life insurance policy. Life insurance companies cover a specific number of illnesses. If an individual suffers from the specified illness, then he stands to benefit from the CI cover.

Both the CI riders as well as medical insurance are entitled for tax benefits under Section 80D for premium payments of upto Rs 10,000 per annum. This limit stands enhanced to Rs 15,000 in case of senior citizens. Tax benefits are also available in case of dependants. Section 80D benefits are in addition to Section 80C benefits.

However, individuals need to note that there is one basic difference between Medical insurance and the CI rider. In case of medical insurance, the individual is covered only to the extent of the actual expenses incurred on medicine/ hospitalisation (upto a maximum limit of the sum assured). This is unlike the CI rider where the entire amount of CI cover is paid to the individual. This payment is irrespective of the actual expenses incurred by the individual.

From a retirement planning viewpoint, it is therefore important that individuals take into consideration unforeseen expenses. Especially when the costs are low and the benefits high!

5 steps to retirement planning

The longest of journeys start with a single step. We are not sure who said that, but being in the financial planning space, we think it most aptly describes what retirement planning is all about. Planning for retirement is one long journey but a resolute and systematic step-by-step approach makes it a lot less laborious.

1. Start early

A well-prepared approach towards any goal is usually the result of an early start. Retirement planning is no different. We hear financial planners say that it's never too early to start saving for retirement, they are right. Make no mistake that an early start helps and you will be surprised at just how much it helps. Your friend or colleague who started saving for retirement even five years earlier than you with the same quantum of investments is likely to save twice as much as you at retirement. Our article on 'The importance of starting early!' provides ample evidence of this fact.

Even if you don't have the requisite amount of money required to start, the key lies in starting with what you have and making up for the deficit at a later stage. However the opportunity to make an early start should not be compromised with.

2. Seek the assistance of a financial planner

Planning for retirement can be fairly uncomplicated. You need to have a good idea of where you want to be 30 years from now in financial terms and what kind of a lifestyle you would like to maintain. However, putting the financial plan in place (which has a lot to do with math, an unpopular subject with a lot of us at school) can be quite complicated. This is where an investment advisor steps in. He can give a concrete shape to your retirement plan by coming up with 'the all-important figure', based on your inputs and chart out a plausible investment strategy for the long term.

3. Implementing the plan

Having an investment plan in place sets the ball rolling for you and your investment advisor. He will now implement the plan by making investments in stocks, mutual funds, bonds, small savings schemes and fixed deposits among other investment avenues. Your risk profile is the most important reference point for the investment plan. The objective is to invest in avenues that lower risk and maximise returns and do so in line with your risk profile.

Asset allocation i.e. investing across assets in varying degrees will play a vital role over the long run. This is where the investment advisor's expert advice will play a crucial role. Typically a retirement portfolio should be well-diversified across pension plans, mutual funds, equities, EPF/PPF and fixed deposits.

4. Tracking/reviewing the plan

Your investment plan must be monitored regularly to make sure that you are on course to meeting your objectives over different market cycles without compromising on the risk. Again, your investment advisor has an important role to guide you in this regard. For instance, with the robust performance of equity markets over the last couple of years, you are probably over-invested in equities and have therefore taken on more risk than usual. You will have to liquidate some of your equity investments to bring it in line with your risk profile.

With passage of time as your risk profile changes, the same will be reflected in your investments as well. The portion of investments in market-linked products like equities and mutual funds is likely to reduce; instead greater allocations could be made in assured return avenues like fixed deposits.

5. Don't dip into your retirement savings

Since retirement money is sacred it is important that you treat it as such. Your carefully drafted investment plan need not go for a toss every time you witness a cash crunch. Avoid dipping into your retirement monies, unless it's urgent. A one-time sum of Rs 5,000 invested over 30 years (at 10% compounded growth) will swell to Rs 100,000. That is what long-term investing can do for you, so money needs to go into your retirement savings kitty and not come out of it.

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www.personal*fn*.com is one of India's leading financial planning initiatives.

We are a part of Quantum Information Services Ltd., which is one of India's most experienced research houses (set up in 1990). Quantum also offers equity research via its online initiative, www.equitymaster.com.

Our offerings

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- Research on mutual funds and debt instruments
- Home loan solutions in Mumbai
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Our publication

- Personal*fn* also publishes the Money Simplified, a free-to-download bi-monthly guide to help you plan your finances better.

Contact information

To benefit from Personal*fn*'s services, please call us at

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Alternatively, write to us at info@personal*fn*.com or visit www.personal*fn*.com

1. Which are your preferred avenues for investment?
   - ☐ IPOs/Primary markets
   - ☐ Secondary markets
   - ☐ Mutual Funds
   - ☐ Debt Instruments (if yes, please specify)
   - ☐ Real estate
   - ☐ Bullion

2. What is the value of your investment in mutual funds?
   - ☐ Less than Rs 1 lac
   - ☐ Between Rs 1 - 5 lacs
   - ☐ Between Rs 5 - 10 lacs
   - ☐ More than Rs 10 lacs

3. Do you use a computer ?
   - ☐ Yes
   - ☐ No

4. Do you have access to the Internet ?
   - ☐ Yes
   - ☐ No

5. Who do you consult before making an investment ?
   - ☐ Friend
   - ☐ Broker
   - ☐ Financial magazines (if yes, please name some)

   a. ________________ b. ________________ c. ________________

   - ☐ Dailies

   a. ________________ b. ________________ c. ________________

   - ☐ Internet

6. Which are your favourite financial websites?

   a. ________________ b. ________________ c. ________________

7. Have you visited www.personal*fn*.com?
   - ☐ Yes
   - ☐ No

FEEDBACK

8. If yes, which sections of the website do you visit the most?

   a. ________________ b. ________________ c. ________________

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   ____

10. Would you like to apply for a personal finance product on the Internet?
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12. Please give your suggestions for improving the Money Simplified?

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