Financial Planning & Managing Personal Finance

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Financial Planning is a Goal based planning in order to accomplish various goals namely buying a dream house/Car, Overseas Vacations, Children Education/ Marriage and Retirement Planning. One goes on to say "***Proper Planning Prevents Poor Performance***." Three stages to be considered in Financial Planning comprise of Wealth Creation, Wealth Preservation/ Accumulation and Wealth Distribution.

Financial Planning process involves understanding requirements, preparing a tentative-cum-final plan for execution followed by periodical reviews and re-balancing. ***Financial Planning concept*** includes building an Investment as well as Insurance Portfolio, linked to Income and Savings. Asset allocation to be done based on the risk profile along with Tax Planning and Estate Planning.

Normally, income is derived from *active* sources as well as *passive* sources. Combining these two, one has to allocate expenses in a certain proportion with emphasis on savings. While preparing Financial Plan, existing assets as well as liabilities to be considered for fund allocation to various goals. There are *flawed* ***notions*** that Financial Planning is only for rich, which is not so, even one with surplus/savings of *₹500/- per month* could start Financial Planning to achieve various goals.

While planning, one has to always set aside funds equivalent to 3-6 months' Salary/Income for meeting contingencies of Life where ups and/or downs are bound to happen. These funds should be kept in the form of Cash or Cash Equivalents, so as to redeem them as soon as possible. The contingency could be medical reasons, loss of job, economic slowdown in business and unforeseen circumstances. The Cash Equivalents could be defined as Savings Deposit, Liquid Funds, Short Term Fixed Deposits and 2-in-1 Bank accounts.

Usually, Investors aim to build an ***Investment Portfolio*** only whereas ***Insurance Portfolio*** is equally important as Investment. Investments could be in Real Estate, Direct Equity (Shares), Equity-linked instruments (Equity & Balanced MF Schemes), Bonds (Tax-free & Taxable), Debentures, Debt MF Schemes, Government Small Savings Schemes, Fixed Deposits, Bullion/Metal, Currency, Commodities, Art & Artefacts and Alternate Investment Funds.

Insurance Portfolio should aim to cover protection in the form of *Term Insurance* equivalent to at least 10 times of annual income. The purpose is to make provision for regular income to the dependent family, in case of demise of the earning member. The endeavour should be to get the protection immediately after commencement of employment/business. This will ensure adequate coverage at low premium that gets blocked for a longer duration to cover the risk, depending upon annual income. Second aspect is to cover oneself with *personal accident* insurance

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cover for which a nominal premium may be required or it could be obtained as rider with Term Insurance Cover. Personal Accident Insurance cover takes care of permanent disability coverage even when one is alive.

Health Insurance (family floater) for self and family is required to cover hospitalization expenses. In case employed with Government/PSU/Corporate, health coverage is provided by the employer but, additional coverage is advisable depending on cost of hospitalization or non-availability of health insurance cover post-retirement. *Critical-illness* is an expensive proposition for which an exclusive policy may be obtained or a top up insurance cover could be taken along with health insurance cover. While Health Insurance benefit is available, generally, upon hospitalisation. Critical illness coverage results in lump sum payment upon identification of illness.

Post coverage of Insurance Portfolio, one has to understand ***Risk Profiling*** part of the Investors, based on certain questions derived out of individual/entity behaviour to ups and downs (volatility) of the prices. This risk profiling would be more related to Stock Markets performance although it applies to all asset classes. Generally, risk is classified into three types namely, ***Conservative***, ***Moderate*** and ***Aggressive***.

Risk vs. Return

Returns are linked to the risk taking ability of an individual. *Risk-Return* profile of an individual is one's level of *tolerance*. A high risk venture/investment is generally associated with high returns. Securities and Exchange Board of India (*SEBI)* has categorized three risk-return profiles for investors: -

Conservative: One takes *minimal risks* ensuring one's fund remains secure. One would prefer investing in Government Small Savings Schemes, Bank Fixed Deposits and Government Securities where one gets *guaranteed* kind of returns on the funds invested.

Moderate: One is willing to take *some risks* when one is inclined to invest in market-linked investment schemes. Generally, these type of investors prefer investing in combination of Equity and Debt funds, which are also called Balanced Funds and/or Hybrid Funds.

Aggressive: One is willing to take *high risk* and prefer investing in direct equity, mid-cap and small cap equity, Alternate Investment Funds, Commodity markets and derivative instruments where one may even ***lose*** part of the capital.

Risk profile might undergo change during the course of employment/business. Therefore, monitoring, periodical review and re-balancing of investments is advisable. SEBI has allocated colour coding basis risk profile of an investor; *Blue* colour depicts Principal at *low* risk, *Yellow* colour represents Principal at *medium* risk and *Brown* colour means Principal at *high risk.* While it is advisable to start building retirement corpus as soon as one *commences earning* for a sizable corpus at the time of retirement but one could start investing whenever surplus funds are available either in *lump sum* or through *Systematic Investment Plans.*

There are two maxims which apply for *Risk Averse and Aggressive* Investors in the form of *"Lower risk lower gains" and "Higher risk higher gains" respectively.*

In order to *inculcate savings habit* among citizens, Government provides certain Tax Savings benefits, which is an avenue for *Tax Planning* by investors. These types of investments from citizens, are also part of the Government long term borrowing program. In other words, investments by Citizens into Tax Saving instruments are a borrowing by the Government where it has to pay interest on the borrowed funds.

These Savings are utilized by Government for funding various development plans and/or Citizen Welfare schemes.

Individuals earning income, above exemption limit, beginning of Financial Year is the most opportune time to make *Tax Planning* for the running year when *Salaried Employees* have to submit *Investment declaration* under various Tax Saving Schemes. Based on the declaration made, TDS is deducted every month till the time employer asks for the Investment proof during last quarter of FY, to validate the declaration. Thereafter, proportionate TDS is recovered from the Salary for the remaining period of the FY. Similarly, *Businessmen, Self-employed* and *Professionals* earning income beyond threshold could also make their Tax Planning well in advance rather than waiting till the end of FY. Let us discuss important sections of Income Tax Act, 1961, as modified from time to time, where investment could be planned to get tax deduction: -

Section 80 C: Maximum Deduction ₹*150,000/-* Investments in Provident Fund (*PF)*, Public Provident Fund *(PPF)*, National Savings Certificate (*NSC*), Bank Fixed Deposit (*FD),* Life Insurance Premium (*LIP*), Equity Linked Savings Scheme (*ELSS*), Housing Loan *Principal* repayment and National Pension Scheme (*NPS*).

Section 80 CCD (1B): Exclusive Deduction ₹ *50,000/-* National Pension Scheme *(NPS)* only.

Section 80 D: Maximum Deduction ₹*25,000/-* for Self & Family; ₹ *50,000/-* for Senior Citizen and/or Parents (SC) in the form of *Health Insurance* Premium.

S*ection 80 E: No limit* on Interest on *Education Loan* for self or dependent.

Section 80 TTA: Maximum limit of ₹*10,000/-* for interest earned on *Savings Deposit.*

Section 194 A: Maximum limit of ₹*50,000/-* for interest earned on *Deposits* in Banks and Post Offices for ***Senior Citizens*** only.

Section 24: Maximum Limit of ₹*200,000/-* for Interest on *Home Loan*

Retirement is that period of life when an individual is no longer working or is at the commencement of such a period. In case of attaining superannuation or a *planned* retirement there are no issues but it is worrying when it is *unplanned;* when the wage or salary is the only means of income; when one's home life is unhappy and working was an escape; when there is pre-existing bad health, according to a *Harvard* Study.

Post retirement *challenges* are likely to be to maintain healthy lifestyle; socialize; travel; keep oneself engaged and plan one's finances well to retain pre-retirement life style. The activities undertaken post retirement could be part-time employment, volunteering for a social cause, engage in third full time careers, provide consultancy and last but not the least - keep enjoying retired life.

Why *Retirement Planning* is important? The purpose is to help one to maintain the required lifestyle; to ensure self-sufficiency at retirement; provide for contingencies and achieve pending goals, if any. The *Financial Challenges* faced post retirement includes Inflation, Tax on income, Discretionary spending, Healthcare and Personal responsibilities & Issues.

Considering aforementioned challenges one need to ask oneself - Is one *ready* for the retired life? One can lead a *normal* retired life, other option is to lead a *luxury* life and third one is to live a *super luxury* lifestyle. The choice would depend on the financial planning process adopted in the pre-retirement period. Whether you preferred *investments to savings*

as investments provide higher returns to make you *wealthier* whereas savings is to keep cash aside or deposit funds in savings account. If one takes housing and education *loans* for meeting goals of House and Child education respectively then it makes sense to *avail tax benefits.* Otherwise it is *risky* proposition to avail loans for the purpose of investments.

Estate Planning is also an important aspect of Financial Planning where seamless transfer of Wealth after your demise to successor or legal heirs is ensured. *Wealth* means all assets one owns which includes property, vehicles, jewellery etc. If there are any liabilities of the deceased those also get transferred. While Investors in India do focus on *wealth accumulation* as well as *wealth preservation* processes they are ignorant about importance of *wealth distribution*. In India, family legacy could get passed on to the inheritors, minors are exceptions, without much of the *tax incidence*, hardly requiring an *expert advice* on these matters. This scenario has changed over a period of time when reputed *family conflicts* surfaced in the *public domain*, in the absence of proper *Estate Planning*.

Wealth accumulation takes place for ***f****inancial security; upgraded lifestyle;* legacy for *future generations* and fulfilment of ***e****xpensive hobbies/goals*. Wealth transfer, in the absence of Estate planning, is one of the major reasons for *loss of assets* that can be addressed by having discipline in using assets immaculately and preserving it. Wealth transfer planning may not mean *seamless transfer* but it certainly forms *building a block* for a good estate plan.

Estate Planning is necessary to avoid *family disputes; dependents survival;* perpetual existence of *business/enterprise;* ensuring use of wealth for *causes and charities* planned; preservation of *family objectives; Taxation and inheritance costs*.

In view of the challenges likely to be faced in the absence of succession planning, it becomes pertinent to have Estate Planning for *seamless transfer* of wealth/estate, post one's demise, to successors and/or legal heirs. Wealth does mean all assets owned by the head of the family that includes real estate, financial assets, bullion, family business, movable assets and Art & Artefacts. Even liabilities also get transferred along with assets.

Wealth distribution could be ensured by way of *nomination*, formation of *family/private trusts,* preparing a *registered will* or ***codicil*** and transfer for *charity* purpose.

Last but not the least, the vital part of Financial Planning is monitoring investment at periodic intervals and re-balancing to be carried out wherever required. The timings of the financial goals are dynamic in nature, which keep changing based on the circumstances. As one's income keeps growing the living standard also goes up. The investments should also be commensurately enhanced gradually. Financial Market conditions depend upon the growth of the Economy, Conducive environment, liquidity, fresh inflows by FIIs and DIIs, Corporate Results and Global cues.

Concluding Financial Planning by writing about *flawed notions*: Financial Planning is for *affluent*; *Insurance* cover is Financial Planning; *Tax Planning* is Financial Planning; *when to start* Financial Planning; *Ambiguity* between Financial Planning and Investing, and last but not the least *Liquidity* versus Investments.

Managing Personal Finance

There are four types of *economic activities* for the individual consumers.

**** Earning***
**** Spending***
**** Savings/Investing***
**** Borrowing***

Earnings could be *active* earnings or *passive* earnings. Earnings by way of *Salary* when employed; running a *business/profession* are active earnings. When one receives pension, annuity, rental, interest and dividend on Investments, these are called as passive earnings. An individual's Career Choice, getting an employment and ability to grow in career/business/profession determines one's likely earnings and standard of living. Coming to the factors those could potentially affect *earnings* are Career chosen/type of job, Geography of employment, Education level, Employability skills, Prior Experience/Performance, Economic Environment, Workplace trends and opportunities, Competence to grow in career/profession/business.

Spending is money consumed for purchasing goods and services. The way one spends money determines the value received, and influences economy. Every purchase contributes to the demand for product or services. An economy can't produce all goods and services that consumer want, and majority doesn't have resources to get what they want, which is also called as *Law of Scarcity*.

Scarcity prevents choices among alternatives; When making a choice, alternatives are sacrificed; Highest valued alternative is sacrificed when choice made is based on the Opportunity cost; Choosing one item above other is called Trade-off; *Responsible Spending* includes researching & planned purchases, and making wise choices in the light of opportunity costs and Trade-offs that apply.

Next economic activity is *Savings*, which means putting aside funds for use at a later date. The form of savings used determines the return on the investment. Keeping cash at home for one full year would mean depreciation in its value by equivalent inflation rate. Putting funds in Savings deposit of a Bank would give a return of 3.5% to 7%, depending upon the Bank/Entity where funds are parked. Making a Fixed Deposit or investing in Government Small Savings Schemes would give you a return from 6.5% to 8.3%. All the aforementioned investment returns are taxable except PPF, Tax Free Bonds and Sukanya Samruddhi Yojna, to name a few. There are other asset classes where funds could be invested depending upon risk appetite of the investor. Savings and Investments are two sides of a coin where investment means deploying funds judiciously. Later usage of *Savings/Investing* could be Contingencies, Routine Expenses, Future Purchases, Financial Goals and Retirement Planning. Benefits arising out of Savings/Investment could be earning passive income, produce a robust economy, provide financial security, growth opportunities for business ventures, *Responsible investing* forms the habit of regular saving and finding avenues yielding higher returns. Equity MF schemes and Debt MF schemes provide market-linked returns on the investments.

Borrowing means procuring funds, goods and/or services today, with a promise to pay at a future date. Maxim applied is "*Buy now and Pay later*". Some of the examples of borrowing could be usage of credit cards, purchases on EMIs, Pay day loans, Cash Advances and availing retail loans. Reasons for borrowing could be major purchases, meet contingencies, convenience, planning for future goals and taking advantage of attractive discount Sales/Offers. *Responsible borrowing* means timely repayment of loans as and when due.