

PERSONAL FINANCIAL PLANNING

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Introduction

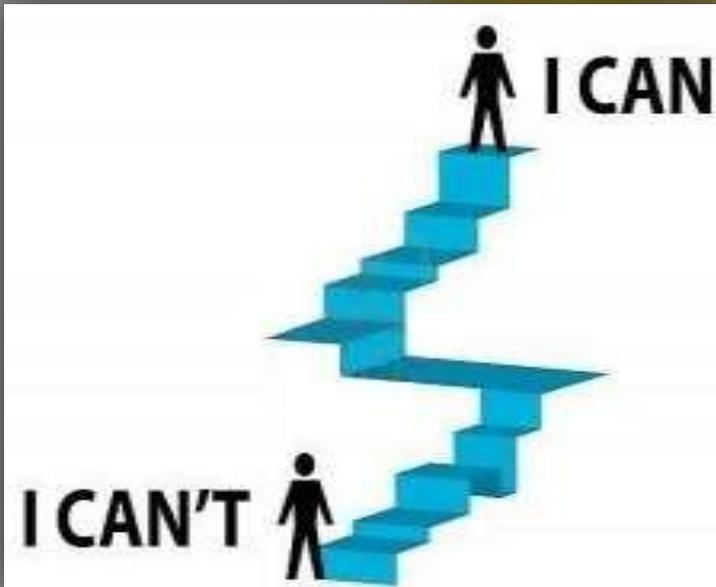
► What is financial planning?

Financial planning is the process of setting, planning, achieving and reviewing your life goals through the proper management of your finances.





Define :-Normally, people always think it is not really possible to fulfill all their goals or dreams without having a High Salary or belonging to a rich family. But it is not the truth. With the help of **Financial Planning** you can achieve all your life goals or dreams.



NEED FOR PERSONAL FINANCIAL PLANNING





S

Specific

M

Measurable

A

Attainable

R

Realistic

T

Time- bound

The SMART principles can help you reach your goals step by step

Step 3: Set your financial goals

- Different needs and goals at different life stages
 - Make a list of all needs and goals
- Set SMART goals
 - Example: My laptop is out of order.
 - S**pecific - *I need a new laptop.*
 - M**easurable - *I need \$7,500 to buy the laptop.*
 - A**ttainable - *I will put aside \$1,500 a month to purchase the laptop.*
 - R**ealistic - *I can save \$1,500 a month by working part-time.*
 - T**ime-bound - *I will save \$ 7,500 in 5 months.*

Step 3: Set your financial goals

- ▶ Young single
- ▶ Possible goals:
 - ▶ Pay off student loan
 - ▶ Pay salaries tax on time
 - ▶ Travel once a year
 - ▶ Get married in 5 years



Step 3: Set your financial goals

- ▶ Just married
- ▶ Possible goals:
 - ▶ Prepare emergency fund
 - ▶ Prepare down payment for a flat in 4 years
 - ▶ Have a baby in 5 years
 - ▶ Prepare for retirement



Step 3: Set your financial goals

- ▶ Married with children
- ▶ Possible goals:
 - ▶ Repay mortgage on time
 - ▶ Hire a maid
 - ▶ Take out an insurance plan
 - ▶ Save for children's education
 - ▶ Prepare for retirement



Set your financial goals

- ▶ Retiree
- ▶ Possible goals:
 - ▶ Preserve retirement fund
 - ▶ Reserve for medical expenses
 - ▶ Carry out estate planning



MISCONCEPTIONS ABOUT FINANCIAL PLANNING

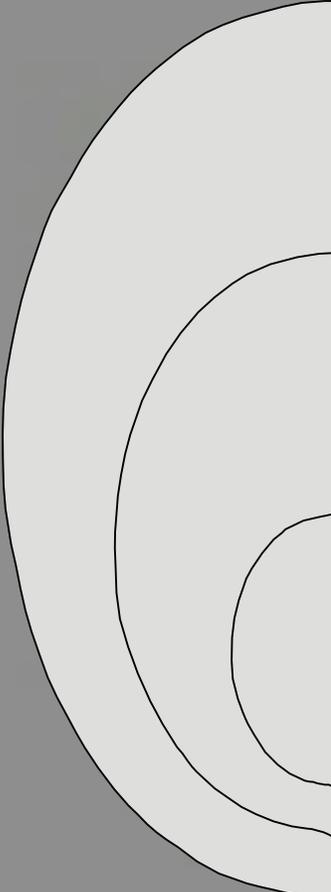
- ▶ **It is a One-time Exercise:** Financial planning is thought of as onetime exercise which is not true. Financial planning requires close monitoring regularly and readjust or rebalance the asset portfolio so that the planned goals can be achieved within the time frame work drawn.
- ▶ **2. It is Only about Tax Planning:** Tax planning is only one aspect of financial planning. Financial planning deals holistically and takes care of investment, protection and estate planning in addition to tax planning.
- ▶ **3. It is to be Done When One Reaches Retirement Age:** Another wrong notion is that financial planning has to be thought of only when one is about to retire or nearing retirement. If one asks what is the right time to start one's financial planning, the answer would be yesterday. That means it should be done at the earliest, as soon as one starts earning money.
- ▶ **It is Only about Investments:** As already seen, financial planning covers not only the investment aspect but also other aspects like insurance, tax planning, retirement planning and estate planning.
- ▶ **Financial Planning Advice is Too Costly:** It is true that one has to pay professional fees to the financial advisor. One should not forget that the benefits which one derives from this advice would be much more than the nominal fee one pays.

MILESTONES IN ONE'S LIFE

- ▶ Birth and School Education
- ▶ □ College Education
- ▶ □ Getting a Job
- ▶ □ Purchase of Car
- ▶ □ Entering the Family hood - Marriage
- ▶ □ Purchase of Building/Flat
- ▶ □ Birth of First Child
- ▶ □ Education of First Child
- ▶ □ Birth of Second Child
- ▶ □ Education of Second Child
- ▶ □ Marriage of First Child
- ▶ □ Marriage of Second Child
- ▶ □ Retirement
- ▶ □ Death

Happy Retired Life

Earnings in Life Stages



Childhood	<ul style="list-style-type: none">• 22-25 Years• No Earning
Pre Retirement	<ul style="list-style-type: none">• 25-28 Years• Earning Period
Post Retirement	<ul style="list-style-type: none">• 30-35 Years• No Earning

PLANNING FOR A LIFETIME

- ▶ (A) Asset Acquisition Planning
- ▶ (B) Liability and Insurance Planning
- ▶ (C) Savings and Investment Planning
- ▶ (D) Tax Planning
- ▶ (E) Retirement and Estate Planning

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FINANCIAL PLANNING PROCESS



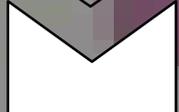
•Setting your Financial Goals



•Developing Financial Plan



•Implementation of the Plan



•Monitoring of the Plan



•If need be, take Corrective Action



•Redefine and Revise Plan

Steps for setting Financial Goals:



1. Write your goals and be specific:

- ▶ When you write your financial goals it will help you to visualize them. It should be specific and realistic.



- ▶ **Identify your time-specific goals: Short -Term Goals:** The goals which you can achieve within 1 year. For example: your child's play school admission.

- ▶ **Medium-Term Goals:** You want to achieve these goals within 5 years. For example: your child's school admission.

- ▶ **Long-Term Goals:** Goals that you want to achieve after 5 years. For example: Retirement, Child's Education and Marriage.

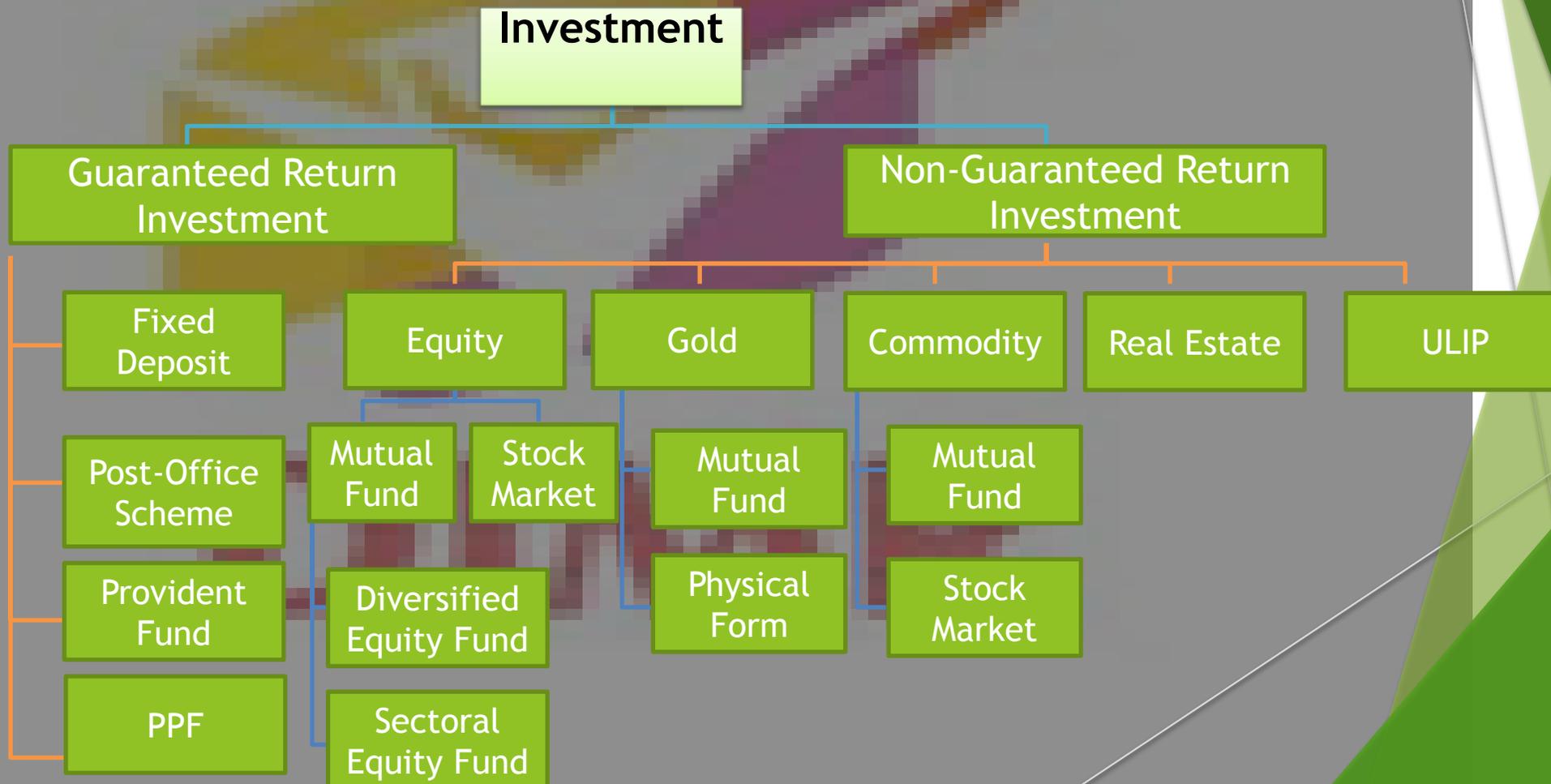


3. Priority.

- ▶ After listing your Financial Goals, it's time to number them according to your priority.



Investment Choices: Investor can create wealth through investment. Two types of investments are available



4. Analysis of your Current Financial Situation



Cash Flow Statement

It will give you the full information of your income and expenditure.

Net Worth

Net Worth is an overall statement of your assets and liabilities.

$$\text{Net Worth} = \text{Asset} - \text{Liabilities}$$



Importance of Cash Flow Statement and Net Worth in Financial Planning

Both the Cash Flow and Net worth Statements will give you a real picture of your present situation and help you make realistic financial goals. Update it regularly. These two vital documents do not replace each other; but they are supportive documents to each other.

Budgeting



In financial planning, budgeting plays a very vital and important part. Budgeting will give you the exact picture of your expenses and spending habits. This will help you to plan your expenses and spending habits more efficiently. If you do not know where you are spending your money just keep a track on your spending habits on a monthly basis. This sounds ridiculous, but believe us, this will definitely help you to reduce your unnecessary spending.

Proper usage of credit card:

It's a unique tool for cash free purchase payment for interest-free grace period with redemption p

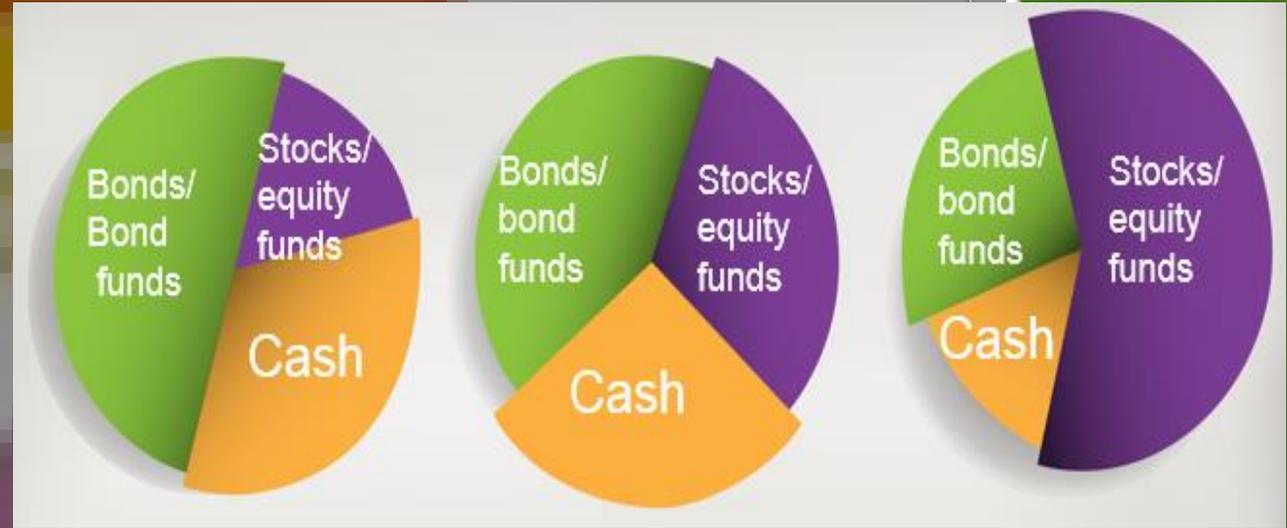


Responsibilities of a Financial Planner

WHY DO YOU NEED TO HAVE A FINANCIAL PLAN?



 finplanyadnya.in



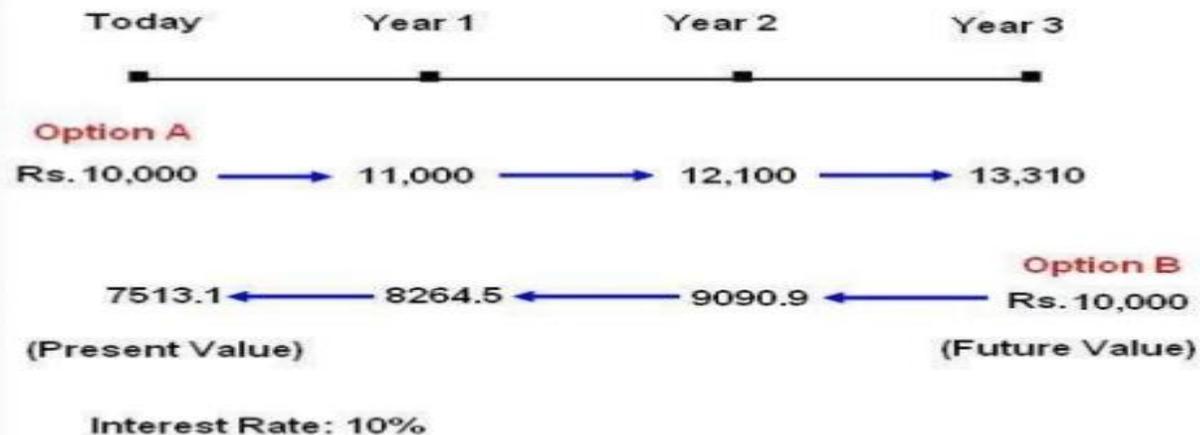
And it secures you and your family's future



Time Value of Money

- ▶ The time value of money (TVM) is the concept that money available at the present time is worth more than the identical sum in the future due to its potential earning capacity.

Time Value of Money



KEY TAKEAWAYS

- ▶ Time value of money is based on the idea that people would rather have money today than in the future.
- ▶ Given that money can earn compound interest, it is more valuable in the present rather than the future.
- ▶ The formula for computing time value of money considers the payment now, the future value, the interest rate, and the time frame.
- ▶ The number of compounding periods during each time frame is an important determinant in the time value of money formula as well.

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KYC

Officially Valid Documents (OVD) for KYC

- ▶ PAN Card
- ▶ Aadhaar Card
- ▶ Passport
- ▶ Driving License
- ▶ Voters' Identity Card

Information collected under KYC

- ▶ Attested copies of the identity proofs such as PAN Card, Driving License, Passport, Aadhaar card, Voter ID
- ▶ Address details with proof of address such as Aadhaar card or any other document specified
- ▶ Contact details including email id, personal cell number, landline numbers of office and home
- ▶ Latest passport size photograph

RISK MANAGEMENT





- Risk is felt everywhere in the environment
- Be it an individual, society or organization
- Father will tell son- Don't speed up the car; Don't visit Srinagar or northeast for Holidays ! WHY ?
- Risk –
 - Immediately we relate it to **uncertainty in the outcome of an event**. The outcome may not be favorable
 - What does it imply ?
 - It implies lack of knowledge about the future and the possibility of some adverse consequence

Tragic events arouse emotions



DI

Risk.....

- Risk is a threat or probability, which can be of the following types:
 - Physical damage to the property
 - Death or injury to self/family members/employees
 - Public liability arising out of the activities carried out
- Risk-
 - Uncertainty about the outcome of a situation
 - The possibility of outcome will be unfavorable

Risk is the probability of any outcome different from the one expected (unfavorable)

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Risk.....

- Risk is a **threat or probability**, which can be of the following types:
 - Physical damage to the property
 - Death or injury to self/family members/employees
 - Public liability arising out of the activities carried out



Risk.....

- Risk is the chance of a loss
- Risk is the possibility of a loss
- Risk is uncertainty
- Risk is the dispersion of actual from the expected results
- Risk is the probability of any outcome different from the one expected (unfavorable)



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Risk- Defined

- **Definition of Risk-**
- **1. Risk is defined as the combination of the probability of an event and its consequences**
- **2. Risk is a condition in which there is a possibility of an adverse deviation from a desired outcome that is expected or hoped for.**
 - There seems to be a possibility of loss
 - Between zero and one; zero- no possibility and one - certainty
- The individual hopes that adversity will not occur, like we don't want our house to be burnt or motor car to be damaged, etc. But it may or may not happen.

Relationship of Uncertainty to Risk

- **Uncertainty refers to a state of mind characterized by doubt what will or will not happen in future (Certainty is opposite mental state).**
- **Uncertainty is a psychological reaction to the absence of knowledge about the future**
- **There is a chance of loss or no loss.**
- **The possibility of loss is the risk.**
- **An asset shall depreciate in value with its use and time is certain but it will be damaged in an accidental fire is uncertain**

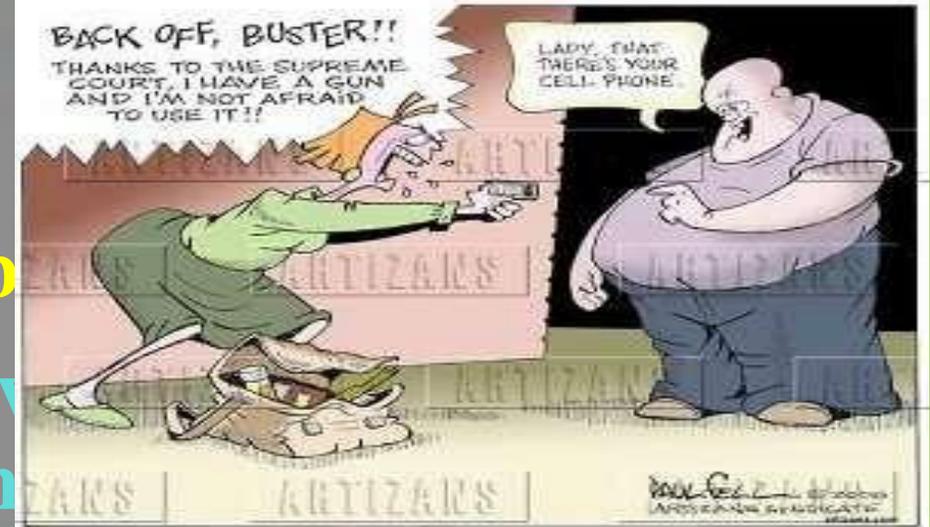
Degree of Risk-

- **Degree of Risk- We use terms like:**
- **More risk or less risk**
 - High Probability or low probability
 - The higher the probability of an event shall happen, the greater is the likelihood of a deviation from the desired outcome
- The probability of death at the age of 75 is higher than that at 50; so the degree of risk at the age of 75 is higher

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Degree of Risk-

- Zero probability mean impossible to happen and 01 means certain to happen
- Therefore the probability of loss is b e.g. as the number of bullets in a revolve probability of loss increases. If all the the bullet, there is no hope of favorable result.



Degree of Risk.....

- Large no. of exposures over a period sets a **trend** which can be estimated.
- Predictions can be made out of these estimates
 - Suppose from the past experience, an insurer found that one out of 1000 houses would burnt.
 - If the Co. insures 100,000 houses, it is unlikely that 100 houses would burn.
 - The actual result will be different- may be less or may be more.
 - But these houses are insured, The possibility of loss of more than 100 houses is Insurer's risk.

Peril, Hazard

- **Peril is a cause of a loss, Fire, theft, flood, storm, etc.**
- **Hazard is condition that may create or increase the chance of a loss arising from a given peril. Sickness is a hazard for premature death**
 - **Physical hazard-** physical properties, e.g. poor construction, property near a river, etc.
 - **Moral hazard-** dishonest tendencies in the character of the insured person that may increase probability of loss
 - **Morale hazard-** indifferent attitude towards insured property, careless attitude towards preventing losses

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How does a risk arise ?

Physical

HAZARDS

Moral/Morale

Contribute to



PERIL

Causes

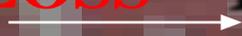


POSSIBILITY OR PROBABILITY OF LOSS

Creates



RISK Possible LOSS



Classification of Risk

- **Financial and Non Financial Risks**
- **Static and Dynamic Risks**
- **Fundamental and Particular Risks**
- **Pure and Speculative Risks**
- **In speculative risk-** there is a situation in which there is possibility of loss and also there is possibility of gain, e.g., game of cards.
- **Pure risk-** there may be a situation in which there is only possibility of loss or no loss. A motor car may face an accident and may or may not be damaged.



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Classification of Risks

- **Dynamic Risks** **Static Risks**

Changes in the economy **Changes in the consumer tastes** **Changes in the price level** **Change or advancement in Technology**

No change in economy **Natural calamities** **Dishonesty of individuals,**
Fire, Accidents, etc.

- **Pure Risks**

Result of an event- Like Fire, Accdt., etc. **No change in situation or Causes loss**

- **Speculative Risks**

Result of an event- Gambling, etc
Gain/Loss

- **Fundamental Risks**

Impersonal in nature- caused
By economic, social and Political phenomenon
War, flood, EQ, Terrorism, etc.

- **Particular Risks**

Personal in nature affecting the Individuals-
Burglary, Fire in a house **Infidelity of an employee, etc**

Financial risk

- **Financial Risk** is often defined as the unexpected variability or volatility of returns.
- **Actual return on an Investment will be different** than expected. This includes the possibility of losing some or all of the original investment
 - **Credit risk**- default in making payments as promised because of cash flow/collection from buyers problem
 - **Market risk**- product price (market conditions), stock price, interest rate, currency rate, etc.
 - **Operational risk**- risk of running a business, goodwill, Legal risk, etc.
 - **Liquidity risk**- Trading of a security or asset quickly in the market, etc.

Classification of Pure Risk

- **Personal Risks-**

- **Premature death**
- **Old age or risk of insufficient income during retirement**
- **Accident**
- **Sickness or disability or poor health**
- **Unemployment**

- **Property Risks-**

- **Direct loss or physical loss to the property- Fire damage to a house**
- **Indirect or consequential loss- additional expenses for alternative a**

- **Liability Risks-**

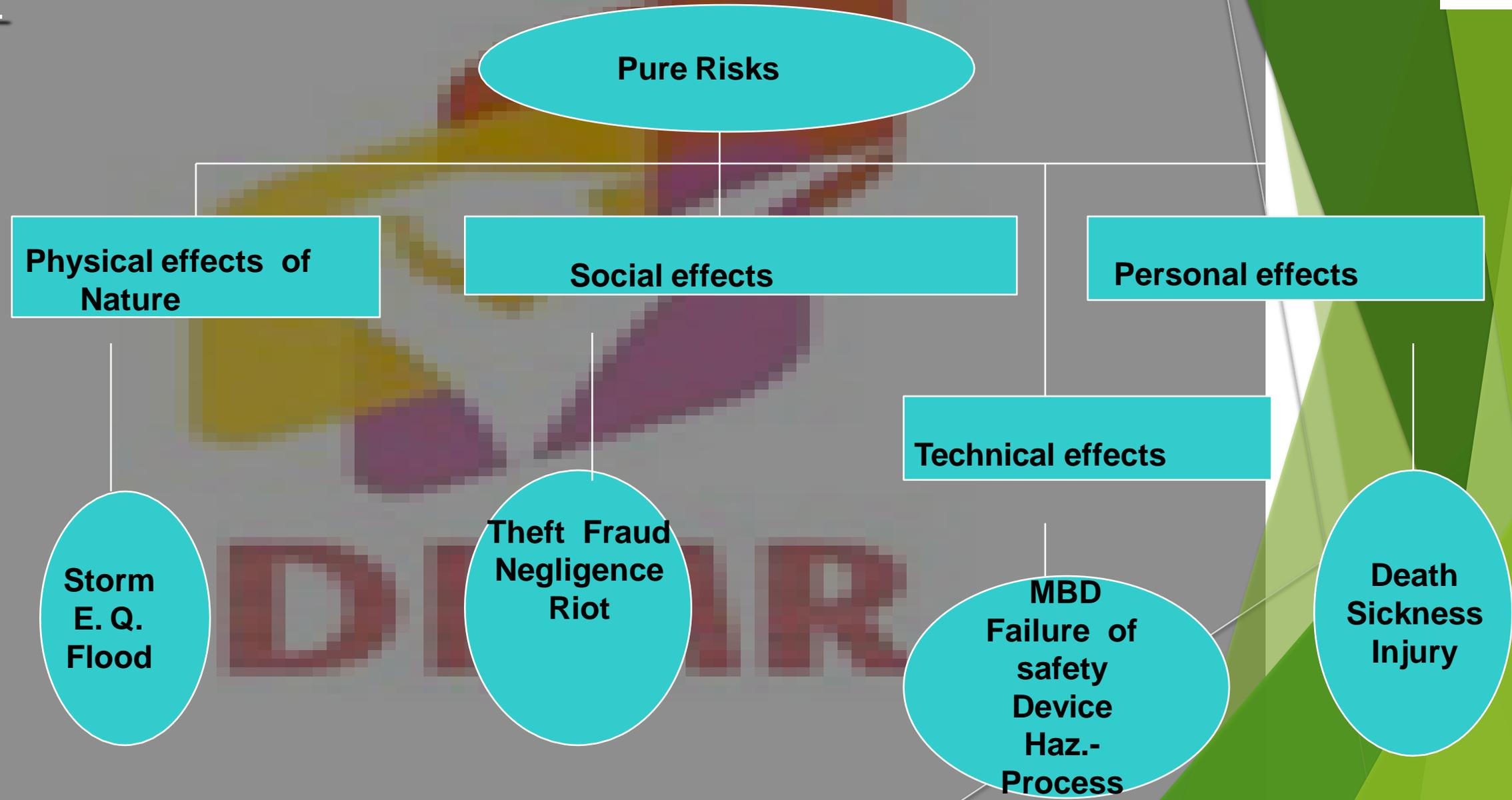
- **Legal liability arising out of Negligently causin bodily injury or los their property; Legal defense cost**

- **Risk Arising out of failure of others-**

- **When the other person could not perform or carry out his obligation expected**



Pure Risk



Costs incurred during a loss-producing event

- Loss producing event involves both direct and indirect costs

Direct costs

- as a result of damage to the property
- as a result of injuries to Self, family members and employees
- as a result of loss in production
- for Accident investigation expenses

Indirect costs

- Liability costs associated with a loss Producing event
- Loss of market, goodwill or reputation
- Effect on the morale of the workers

Costs due to the existence of the risks

- Maintenance Costs- costs incurred while taking an AMC, preventive maintenance
- Costs incurred to prevent liability losses such as effluent treatment, wastewater treatment, disposal of wastes etc.
- Costs to meet the statutory requirements

Private and social costs -----

- **Private costs** --- those costs incurred by **an individual or corporate firm** engaged in a particular activity
- **Social costs** --- Costs arising out of activity of an individual or a firm, but **shared by the society as a whole** indirectly
- **Burden of Risk on Society**—
- **Size of emergency fund must be increased-** to pay the unexpected losses
- **Society is deprived of certain goods and services-** due to risk of liability lawsuit manufacturer may discontinue manufacturing certain product, like medicines, vaccines, etc
- **Worry and fear are present-** accident and its consequences
- **Worry and fear are present-** accident and its consequences

Acceptability of a Risk

- A decision in regard to acceptance or non-acceptance of a risk depends upon
 - The retaining capacity of the organization or the individual
 - The attitude of a person taking the decision
 - Size of the loss
 - Probability of the loss
 - Size of the loss
 - Time
 - Probability of the loss
 - Cost of handling the risk
 - Time
 - Cost of handling the risk

Size->> Probability ↓ V	Small	Big
Low	Low Small	Low Big
High	High Small	High Big

Risk Management

Risk management decisions need to be made prior to knowing what the actual outcomes of unknown perils shall be.

It is the study of :

- all probable causes
 - affecting business and
 - probabilities of all those outcomes
- and then.....

and then.....



Risk Management

- **Risk Management is to reduce the adverse impact of uncertain events**
 - **Uncertainties may be related to Business risks** (speculative) or **Pure risks**
 - **Some times it is difficult to separate the two risks as in case of introduction of new process in a factory**
- **A risk manager therefore adopt a unified approach to deal with all types of risk.**
- **Pure risk can be controlled by Physical control and financial control**

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Risk Management

- **Risk Analysis**
 - Risks identification/anticipation/perception
 - Evaluation/measurement
 - Grading
- **Risk Treatment Techniques**
 - Avoidance/elimination
 - Reduction/control
 - Transfer
- **Risk Financing**
 - Excess/deductible
 - Self insurance/coinsurance
- **Monitoring results/Review**

Benefits of Managing risk

- Minimize the **negative impact** of risks
- **Saving** resources- assets, property, people, time
- **Goodwill**
- **Reduction** in legal liabilities and expenses
- Increasing stability in the operations of orgn.
- **Ability** to face the different circumstances
- Protecting environment
- To know **insurance requirement**
- RM is only a part of **Strategic Management**



Impact of (why) Risk Management



- Survival of the organisation
- Reduced expenses/losses
- Improvement in Profitability-
 - Peace of mind and confidence
 - Bold decision and risk taking ability
 - Stability- less fluctuations in profit and cash flow
 - Goodwill- retaining the customers and vendors
 - Little or no interruption of operations
- Peace of mind and confidence shall help in Sound management decisions & continued growth
- Safety of Organisation, employees, image



Risk Management.....

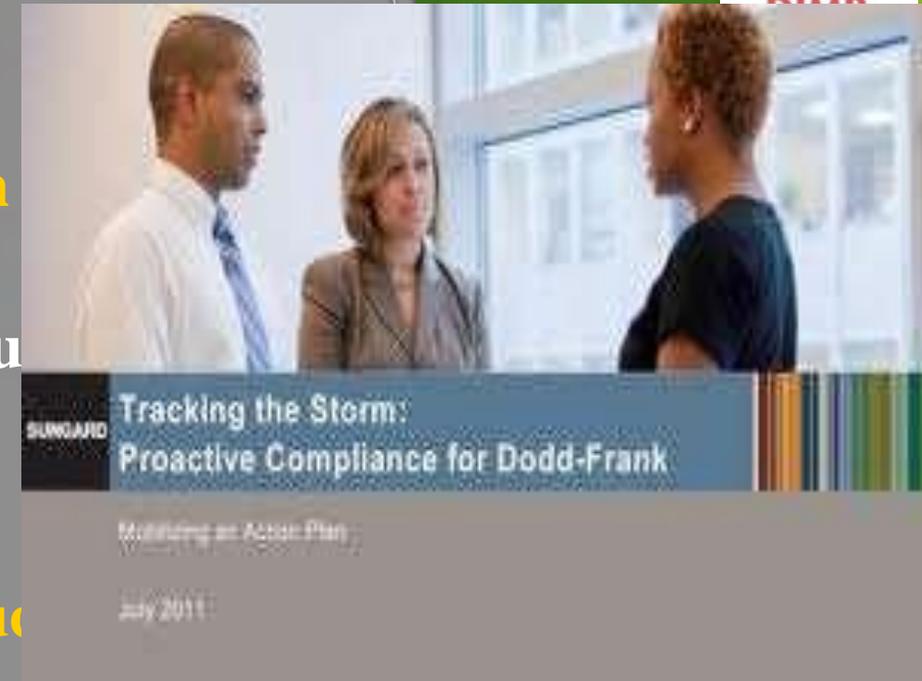
- Different risk management approaches are adopted by different organizations
 - depending upon the kind of risks they are exposed to,
 - the type and size of the organizations and
 - their financial situation
- The likely impact of different risks shall be different,
 - some of which may be retained,
 - other may require reduction/prevention and
 - some may require to be transferred to insurance
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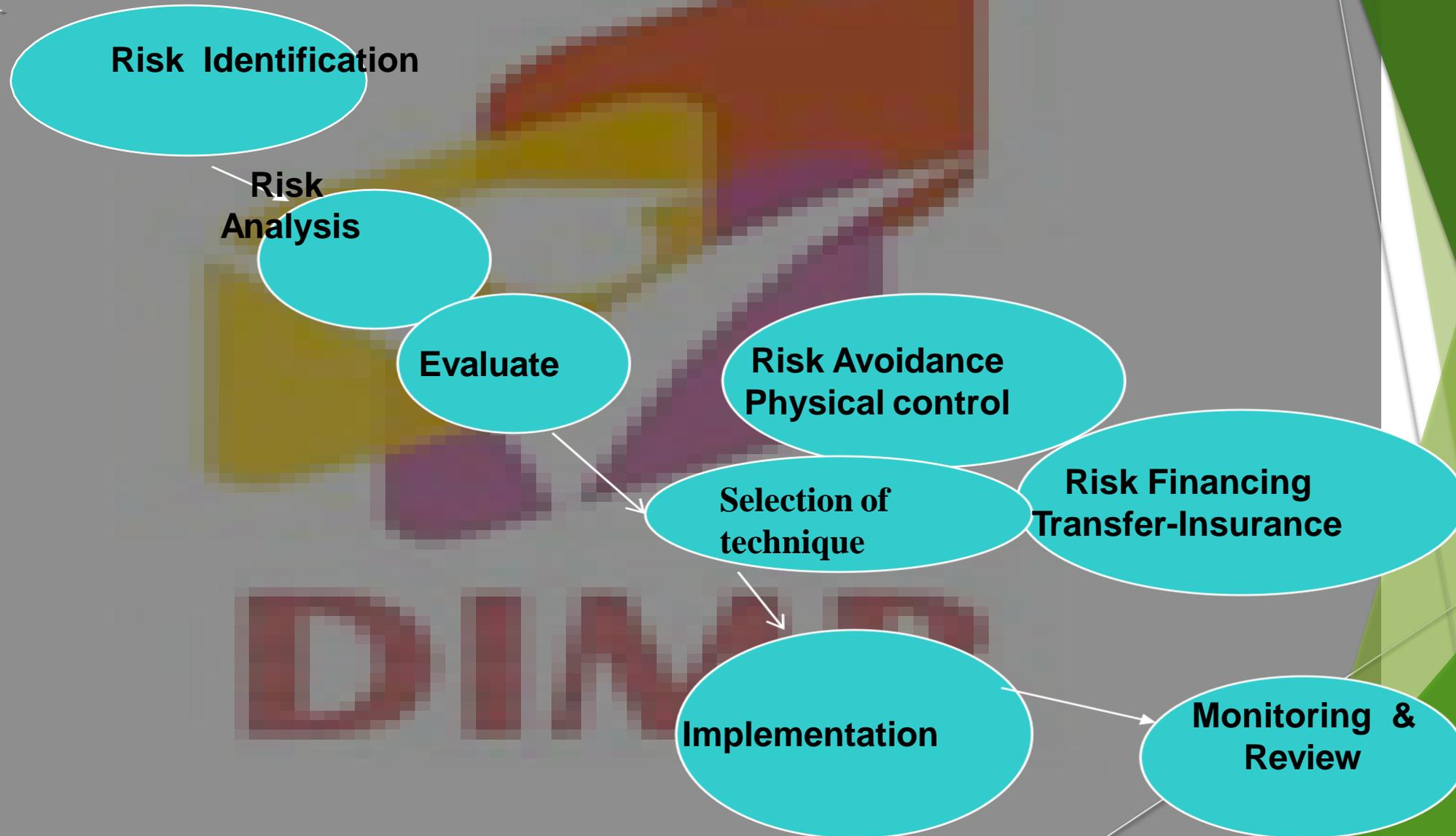
Role of Risk Manager in Risk Management



- **RM has to be specialised person to forecast & plan RM**
- **RM should have knowledge and skills To deal with may face** To deal with the risks that an
- **RM has to cooperate and communicate with various heads of the orgn. to find the different risks and**
- **Coordinate with the persons handling the risks.**
- **To suggest the approach/alternatives to manage such choose best one to implement.**
- **Risk management should have approval of top Management so that plans, activities and controls are established & adhered to in the organization properly**
- **Risk management should have approval of top Management so that plans, activities and controls are established & adhered to in the organization properly**



Risk Management Process



Risk identification

- Risk can be assessed/evaluated, controlled or financed only **after have been identified**
- Objective is to **find maximum number of risks**
- **Missing a risk** can have disastrous consequences
- **One or more method** may be used to identify Risks which may further differ from Industry to Industry
- **Consultation with heads** of various departments of the organisation shall provide valuable inputs
- **The risk** identified should be **loss producing one** and proper record of the same should be maintained
- The past **experience** of the **organisation** and that **of the RM** shall also help in perceiving potential risks



Identification of Risk

- Identification of areas of vulnerability and specific hazards which can interfere with achieving business targets.
- Areas to be looked into:
 - Knowledge about the organization
 - Market in which it operates
 - Business environment
 - Financial strengths and weaknesses
 - Vulnerability to unplanned losses
 - Manufacturing process
 - Management system
- Out of so many methods of risk identification, a combination of best possible methods are applied
- The process of risk identification can be discussed as under:
 - Perception of the Risk
 - Identification of the operative causes and perils along with their likely results



Risk Identification- Perception of Risk

- **Perception of Risk**

- Ability to perceive an exposure
- Identification of possible causes or perils
- The likely result

- **Cause/Source:**

- Type of business and nature of activities carried
- Production method or processing
- Place of activity, at own premises or service to be provided at clients

Environment- in which the organization is working:

- **Legal environment** : laws related to its activity, like public liability, WC Act,
- **Physical conditions** : nearby river, earthquake zone,
- Social and political situations, etc.

- **Role of risk manager is to adopt risk finding techniques which shall be result producing and cost effective**



Factory- what are risks?



Production unit



Stores, Assembly, Fin. Goods, Admn. Block.

Techniques to Risk Identification:

Study & Enquiry



- **Information Sources and documents:**
- Annual reports, Accounts (Balance sheet, etc.)
- Agreements and Contracts
- **Leases agreements- responsibility of damages or losses to building or other assets or property under lease**
- **Contracts :**
 - **Construction or other works: their terms in regard to liabilities of organization like injuries to workmen and physical damages**
 - **Purchase and sale :conditions about liability for the damages and injury**
- **Guarantees/Warranties: After sale service records, expenses so incurred, replacements, etc.**

Perception of Risk.....

- **Accounting records shall reveal:**
- **Exposure: Value of Stocks and assets like –**
 - building, plant and machinery, Furniture Fixtures, office equipments, etc.
- **Interdependencies between different parts of organization,**
 - like production and sale; dependencies on major suppliers and customers
- **Organization's financial arrangements and its own financial position**
- **Past experience about losses and expenditure incurred on them; frequency of such exposures**
- **What shall be the duration of business interruption and size of loss**

Survey

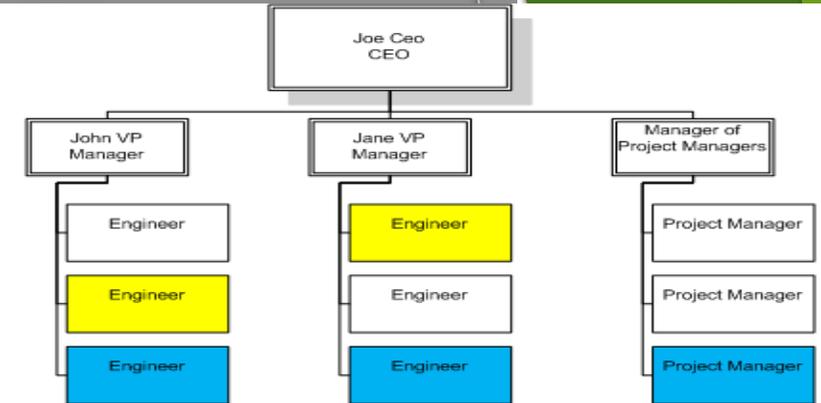


- Site Inspection:-
- **First hand information** to understand the site and to ascertain –
 - **Safety or maintenance** of the plants/operations
 - **Different Risks** in different sites or operations and their likely impact safety & maintenance
 - **Risk handling** capacity available there
 - **Consultation with plant people** will develop rapport to appreciate the controlling of risks
 - **Risk management technique** required there
- **Time consuming** and may be treated as interference



How to Perceive Risk.....

- Organization Charts shall reveal:
- Nature and extent of the organ. Activities,
 - its products,
 - its size,
 - its subsidiaries
- Inter relationship and inter dependence of parts/units
- Splitting the organization into individual profit and cost centers
- Decision making and implementing persons; technical persons
- Organization's weakness which may be cause of a risk



Yellow boxes show team members
Blue boxes show project coordination

Strong Matrix Organization

Perception of Risk.....

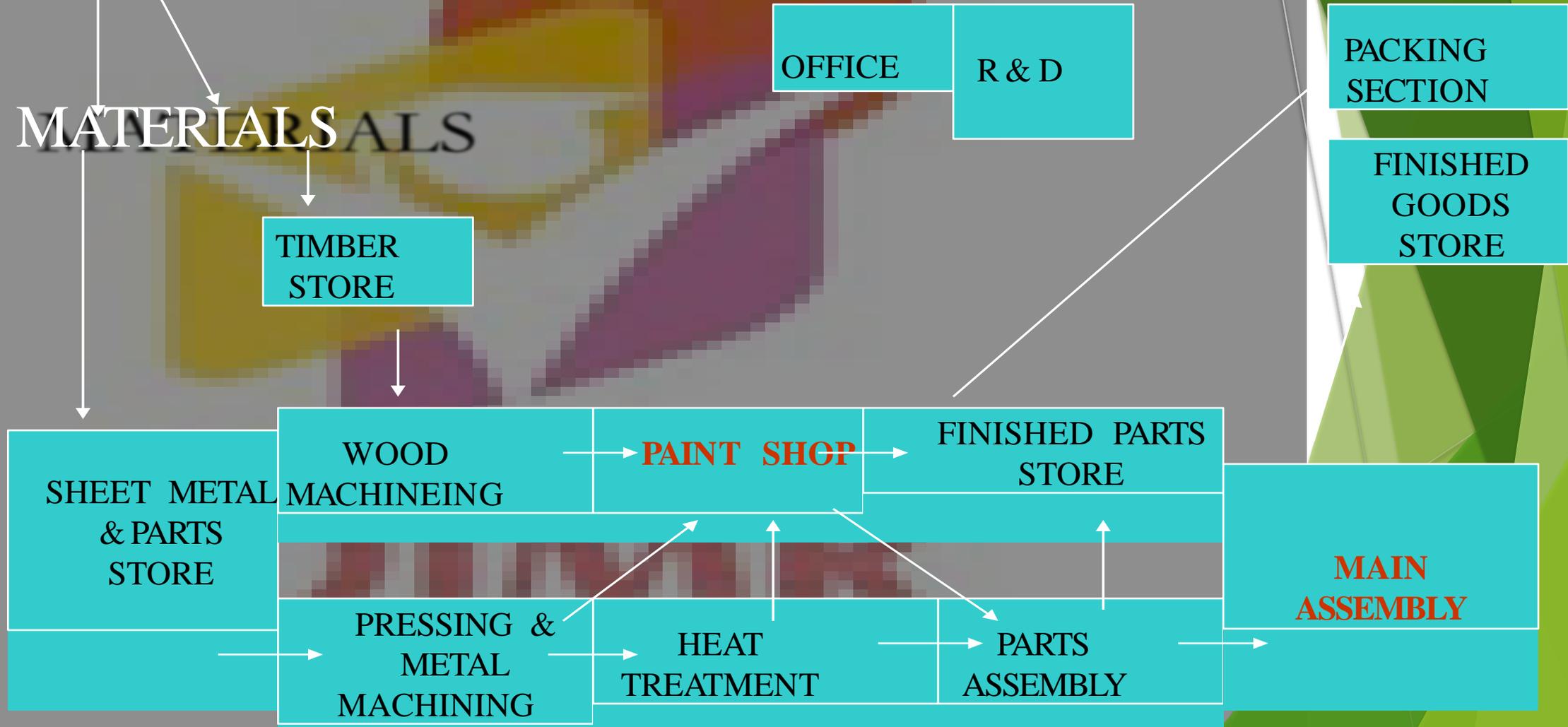
- **Flow chart: Process layout.....**
- **Stage which is critical in the process, any machine which is very important, causes of damage like breakdown, wear and tear, lack of maintenance and its alternative**
- **In house repair facility or nearby workshop capable of repairs in emergency**
- **Source of power or energy required for production**
- **Possible period of repair of machinery in worst circumstances**
- **What shall be potential loss or damage to property and to gross profit**

FLOWCHART



- SUPPLIERS

- MATERIALS



Risks/Perils-Risk exposure analysis



- **Check list: simple in nature & inexpensive**
- Each peril shall be considered, whether a potential threat or not to business operation
- **Like fire-** what can be source of fire; type of construction of the building housing the business, process involved- hazardous or non hazardous, power used; fire alarm system, fire fighting system, nearby fire station
- **flood and inundation-** proximity to river, nalah and level of ground of factory
- **Earthquake-** type of construction, seismic zone
- **Riot Strike and Terrorism-** law and order situation, political, social environment
- **Liability** arising out of possible exposures- like pollution, product defect.

Threat Analysis

- **Threat analysis:** An alternative approach to check list
- Listing of potential threats to business and possible causes
- **Riot, strike** resulting to damage to property and partial closure of business;
- **Picketing-** disrupting the business totally by trade union dissuading workers from working
- **Choking of drainage** system leading to inundation
- **Floods** due to nearby river
- **Epidemics** leading to absence and shortage of workers
- **Blocking of road,** due to subsidence or collapse of building
- **Disruption of supplies-** water, power, supplies of raw material etc. due to damage to supply line

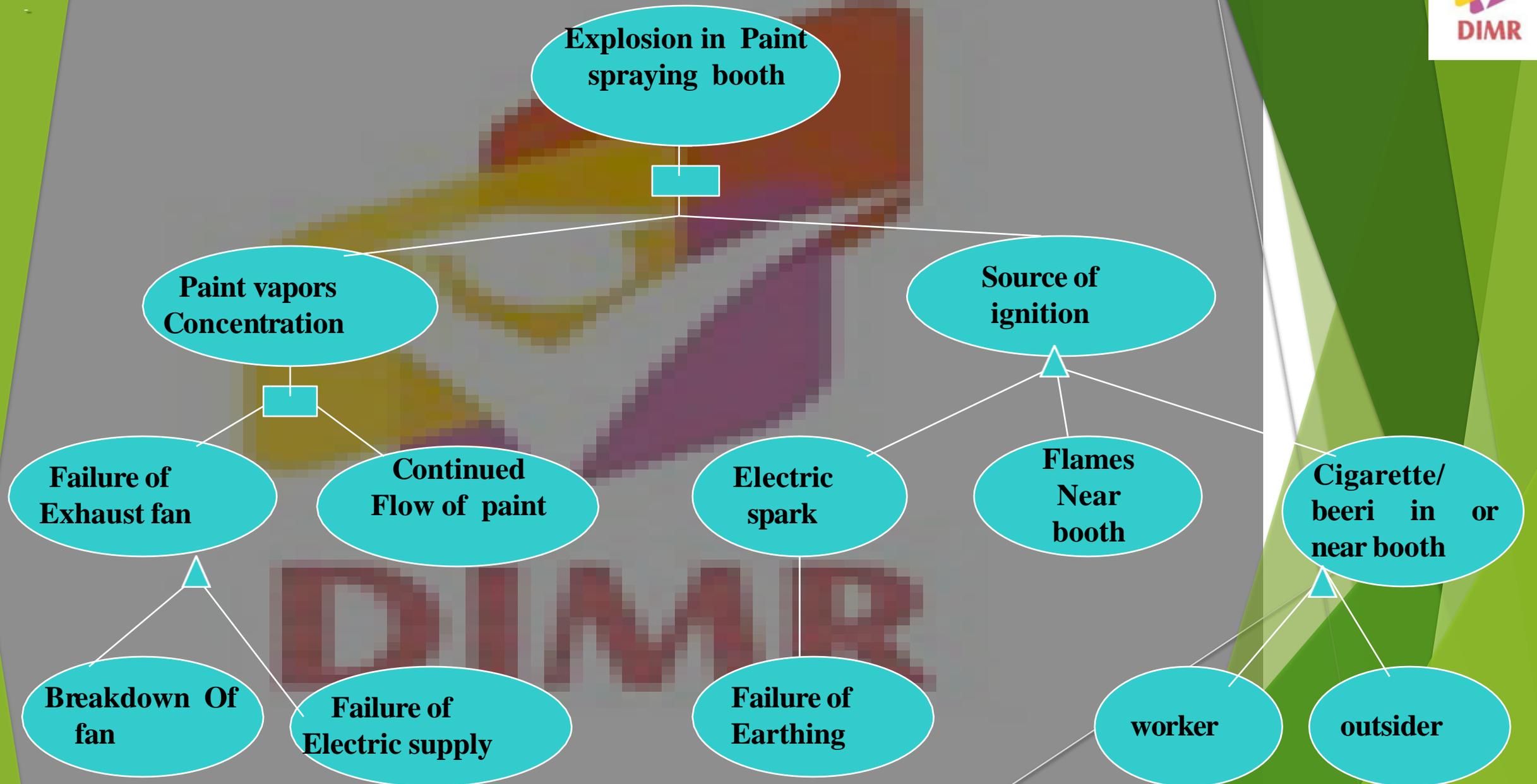
Event Analysis

- **Event Analysis:** Possible loss producing events
- **Natural** – Heavy rains, storm, floods, earthquake, subsidence
- **Man made-** Fire, explosion, Bursting of pipes, Malicious Act, Impact damage, Aircraft damage, closure of roads, closure of various supplies like raw material, water, power
- **The reasons** for above possible events are to be identified to find the remedial measures to be under taken
- The imagination and prudence of the risk manager is very relevant to prepare a Hazard Logic trees. To find hazards which may cause operation of a peril.
- His coordination with relevant persons of the organization and outside organization shall play a vital role to find mitigating factors

Fault tree analysis

- Widely used method of conducting a detailed **quantitative hazard assessment**.
- Fault tree is a **graphical representation** of the logistic relation between a particular accident or other undesirable event- top event and the primary cause event.
- **Top event** is the loss producing event.
- Top event is developed down the branches to the intermediate fault events, which in turn are developed into the primary failures
- **AND gate**
Output exists only when all the input exist.
- **OR gate**
Output exists only when any of the input exist
- **INHIBIT gate**

Fault Tree Analysis



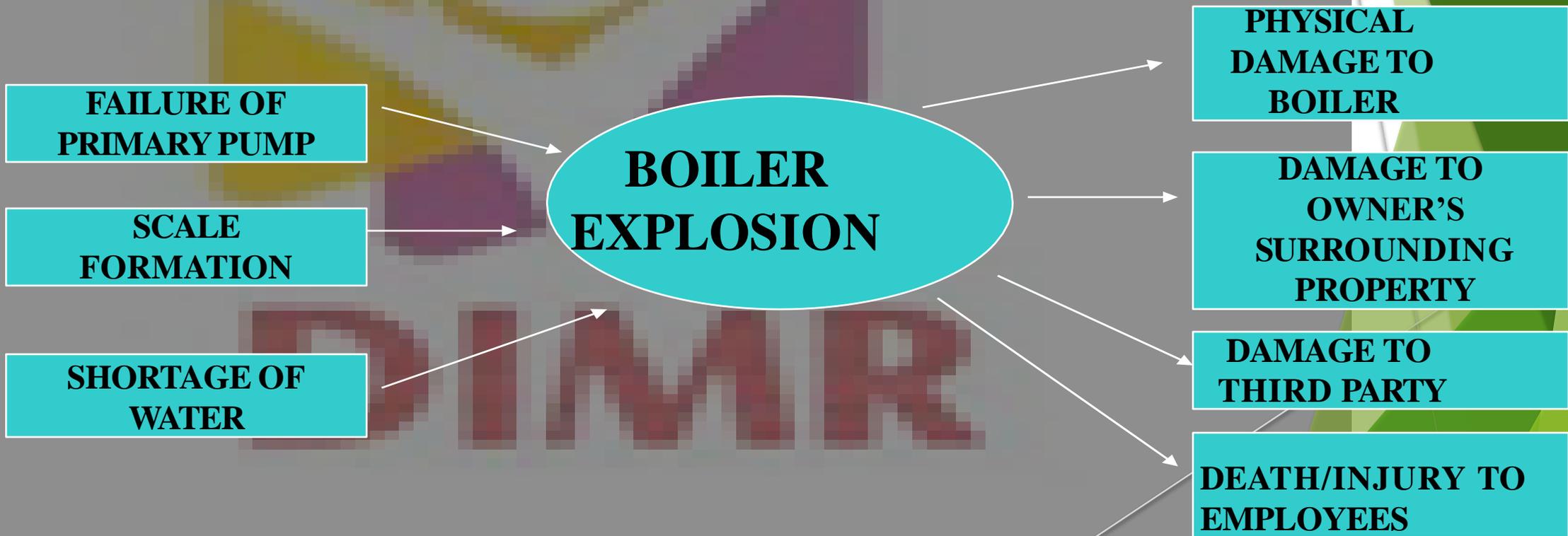
Cause and Consequence Diagrams- Nielson

- This method incorporates features of both- fault tree analysis as well as event analysis.
- Define a critical event- boiler explosion
- Define both the possible causes and the possible effects

DIMR

Cause and Consequence Diagrams

- An event like- a cause and consequence diagram for boiler explosion



Hazard and Operability Studies



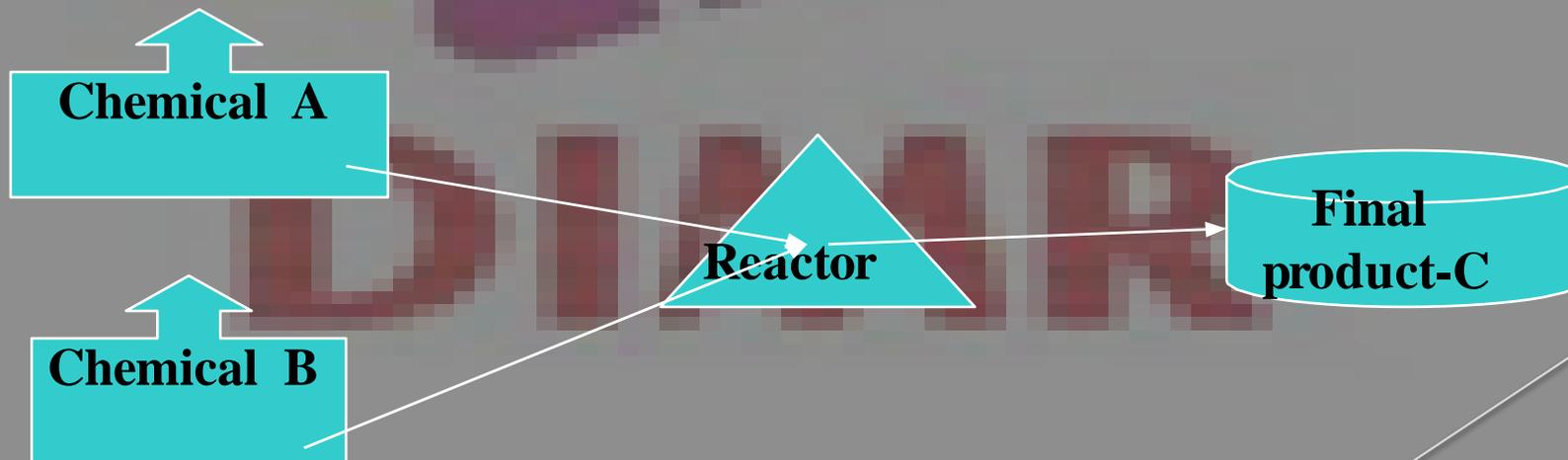
- Hazard identification studies are carried out at the **planning stage of a new plant on the basis of a plant lay out, flow diagram/ process flow sheet etc.**
- Also carried at various **construction stages** of the project
- To ensure that **any changes if required**, can be made as a result of the studies undertaken
- During the studies, full description of the **process** is understood and attempts are made to find out **possible deviations** which may result into adverse consequences (losses).
- Proper risk handling decision can be taken on the basis of such analysis

HAZOP Studies

- Raw material Chemical A and B are transferred by pump to a reactor where they will react to form the final product- C
- $A + B \rightarrow C$
- Condition: **If the flow of B exceeds than that of A then it can lead to an explosion**
- Intention: Transfer A
- Deviation: Don't transfer A
- To design appropriate risk handling method ?

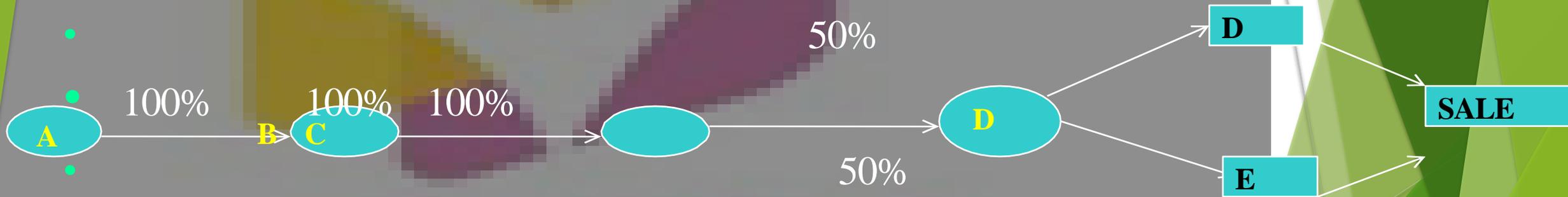
Supply tank of A is empty
-Pump fails
-Isolation valve is closed
-Leakage from pipe

Effect- Explosion
due To excess of B



Input output analysis

- The use of process lay out of where chain of process/sections are involved from input of material to output of a final product
- Example is a manufacturing unit having A,B,C,D,E Section to



- Contribution by each section in total sale/revenue
- Interdependencies among the sections in a process

Safety Audit



- Safety audit subjects every area of the organization's **activities to a systematic critical examination** with the objective of minimizing the losses.
- It examines and assesses in detail the **standard of all facets** of a particular activity
- It extends from Complex technical operations, emergency procedures to clearance certificates, job descriptions, housekeeping and attitudes, Industrial relations, etc.
- Elements of safety audit:
 - Identification of possible loss producing situations
 - Assessment of potential losses associated with these risks
 - Selection of measures to minimise losses
 - Implementation of these measures within the organization
 - Monitoring the changes
- Internal Audits
- External Audits

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Identification of operative causes and perils

- Interrelationship of the terms hazard, peril and loss producing event

Effect of loss producing Event

Peril(s) Hazard(s)

Different techniques are adopted to find hazards involved, in different organizations

Analysis is necessary at each stage of chain: Cause- Risk- Effect

Risk Evaluation

- For proper risk handling, it is necessary to calculate the **potential impact** of the risks identified, on the organisation
- A comparison of Potential impact in financial terms by each risk can be analysed through:
 - **Frequency of its likely occurrence**
 - **Probability of loss or damage**
 - **Severity of the effects of a loss**
 - **Perception of the probability of loss and its effects**

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Risk evaluation.....

- **The risk assessment- to analyze the loss exposure, which require informations**
 - The information in **quantitative form is known as data**, which is collected, analysed and interpreted
 - **frequency of loss producing risk;**
 - **severity of loss;**
 - premium and other costs.
- **For this we need to Examine statistical data on-**
 - The particular operation/company
 - The Industry
 - The country
 - Regionally and worldwide relevant data available

Risk evaluation.....

- **Data related to all the aspects of the organisation in question are examined, like**
 - process,
 - Management,
 - Loss control,
 - turnover,
 - strength of manpower, etc.
- **Constraints of Statistical method-**
 - Only historical data is available
 - Cause of risk cannot be related
 - Data can be manipulated
 - Effects of environmental changes not taken into account

Risk evaluation...

- Adjustments/corrections are also required to be made for-
 - **Volume fluctuation-** growth or decline trend
 - **Inflation-** cost shall be more than the data under study
 - **Increase in Exposure-** Increase in the working hours-24 hrs., diversification or additions
 - **Special circumstances-** Change in legislation or change in insurance coverage
 - **Influence of the Environment-** Economic, social, political, operational changes
- The result of statistical assessment shall help the management assess their impact on the organization in relation to-
 - **Property/assets-** Building, plant Machinery, computers, etc.
 - **Financial assets-** money, debts, insurance, etc
 - **Manpower-** employees, board members, other stakeholders
 - **Liability-** public, product liability, directors' liability, pollution liability, etc.

Risk evaluation....

- Now the risks are to be **prioritized** as per impact into to handle the risks properly-
 - Small and insignificant- **retained or ignored**
 - Small size but frequent- **may be retained but may also be significant if aggregated on annual basis**
 - Medium sized but irregular- **may be controllable**
 - Catastrophe- **large losses may occur rarely but devastating**

OR another method:

Risk Mapping –

HH- **High Frequency and High Severity** LH- **Low Frequency and High Severity** HL- **High Frequency and Low Severity** LL- **Low Frequency and Low Severity**

Presentation of Data

- Collect all the relevant data, e.g. number and size of fire losses suffered by a firm during one year
- Collate the data- arrange in order of increasing size to understand the trend
- Group the losses of different sizes and number of events in each class and record it (class frequency).
- The total range of the data is usually sub-divided into between six and twenty equal class intervals, depending upon volume of data
- The total range of the observations in the example next slide is from Rs. 00 to Rs.600, subdivided into 6 number of equal intervals or width of Rs. 100
- This table is known as frequency distribution

Fire losses occurring during 1980 (Rs.)

99.00	170.55	7.5	199.55	400.00	396.55
102.55	270.00	298.55	390.00	15.00	99.55
330.00	75.00	495.00	230.00	130.55	296.00
2.10	97.55	10.00	260.00	120.00	105.00
520.00	35.00	12.5	20.00	110.00	198.00
20.00	380.00	110.00	55.55	105.00	
20.00	5.0	110.00	250.55	290.55	

Fire material damages losses for 1980 (Rs.) arranging in ascending order

5.0	102.55	210.00	330.00	400.00	520.00
7.5	105.00	230.00	380.00	495.00	
10.0	110.00	250.55	390.00		
12.5	110.00	260.00	396.55		
15.0	110.00	270.00			
20.0	130.55	290.55			
20.0		298.55			
35.0	170.55				
55.55	198.00				
75.00	199.55				
97.55					
99.00					
99.55					

Frequency distribution for fire material damage losses for 1980

<u>Class interval</u>		<u>Class frequency</u>	<u>Mid- point of class interval</u>
Rs.			Rs.
0-	99.5	14	49.75
100-	199.5	11	149.75
200-	299.5	8	249.75
300-	399.5	4	349.75
400-	499.5	2	449.75
500-	599.5	1	549.75
		<u>40</u>	

Over 80% of all fire losses are less than Rs.300 and that 35% lie between Rs. 0—Rs.99.5

The value lying mid-way between the upper and lower class limit is known as the class mid-point, to be used for further statistical analysis

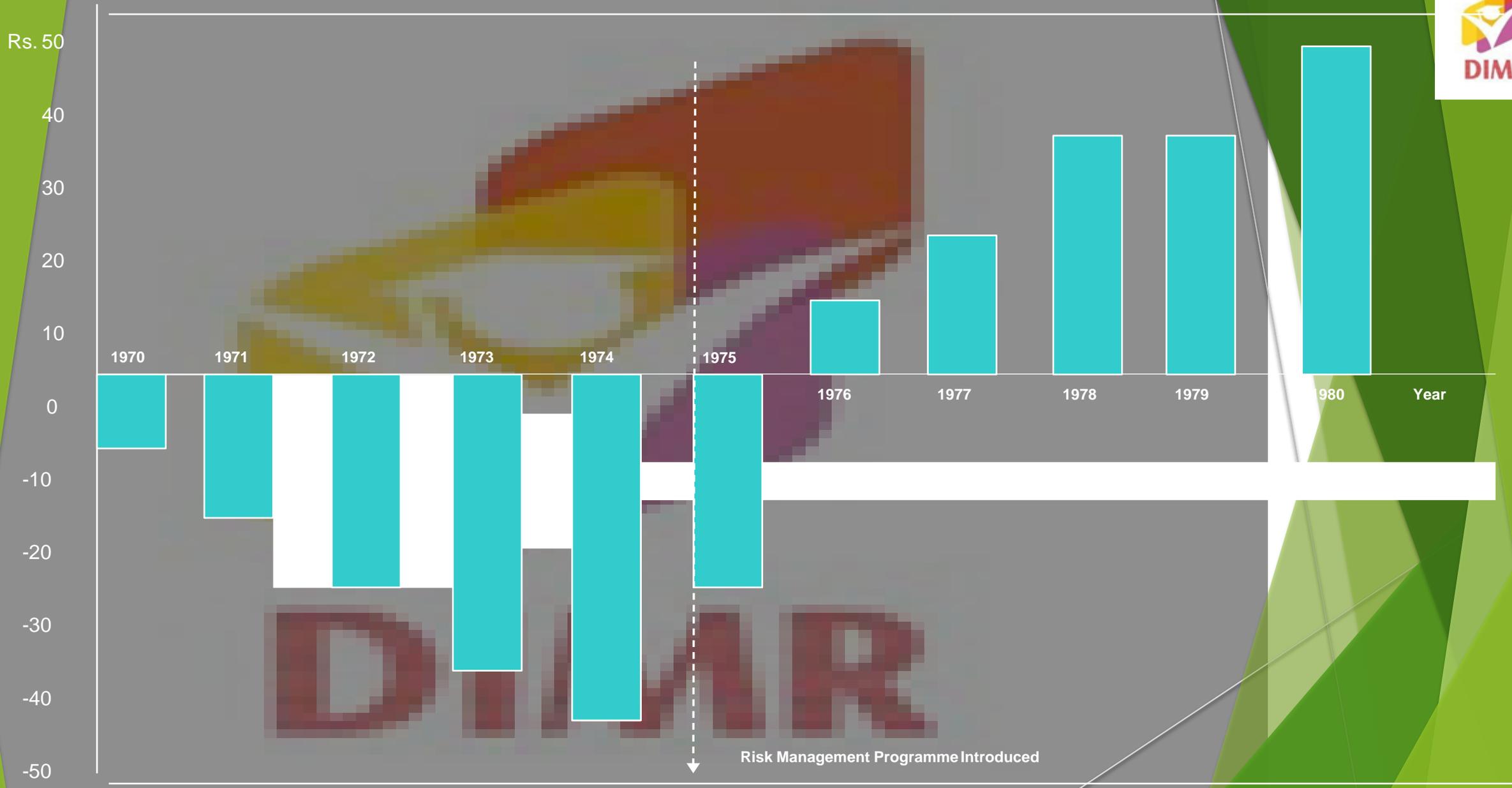
Graphical representation of Data

- Graphs and diagrams are among the most impressive modes of presenting the data
- Bar Diagram: can be vertical or horizontal parallel bars of equal width and of lengths proportional to the frequency of the particular classes
- Specimen bar diagram is given in the next slide drawn from the data provided

DIMR

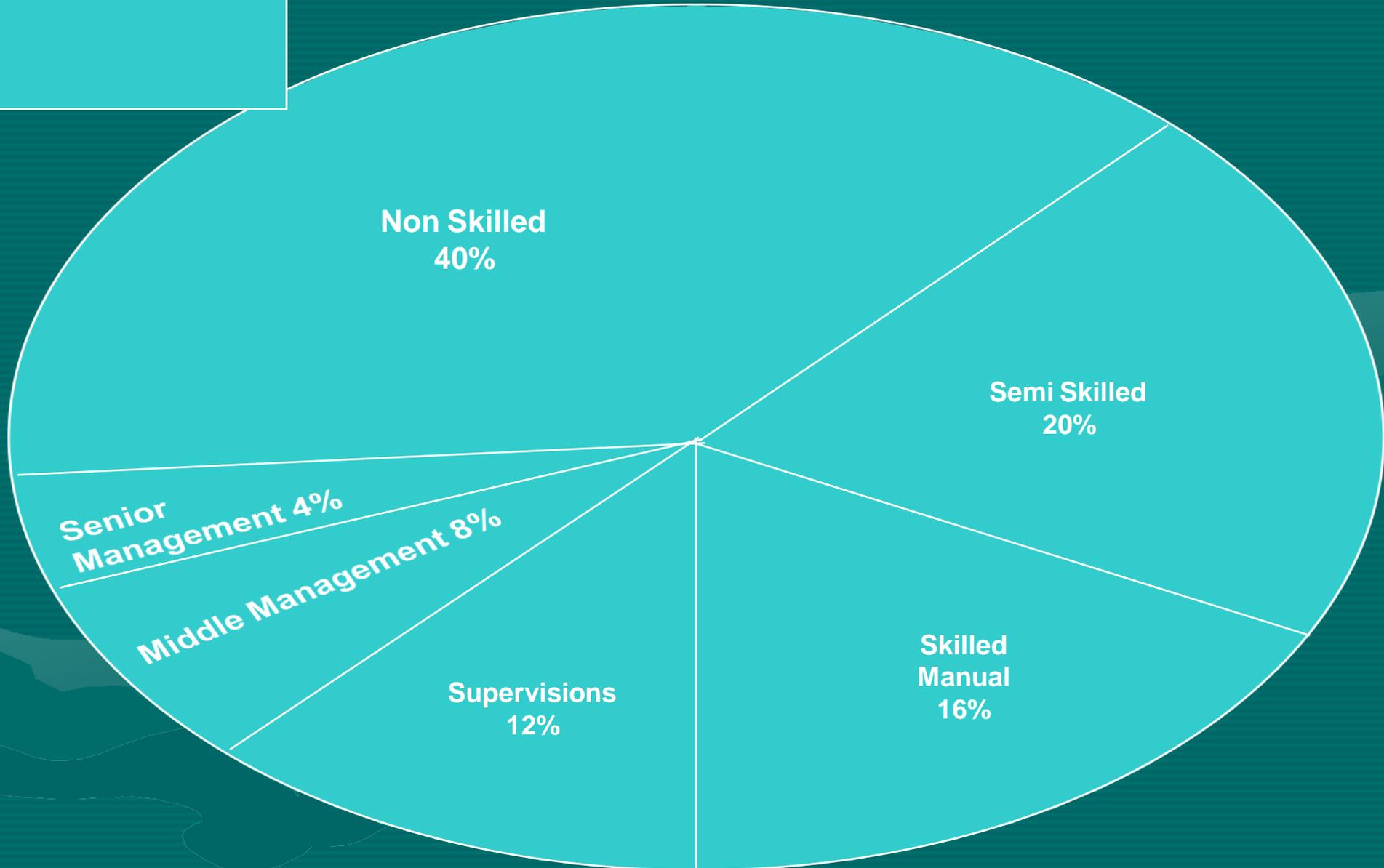
Company Y's annual results before and after the introduction of a risk management programme

Year	Profits/losses (Rs. 000)
1970	-10
1971	-20
1972	-30
1973	-40
1974	-50
1975	-30
(Risk Management Programme started 1 st January 1975)	
1976	10
1977	20
1978	40
1979	40
1980	50



Bar diagram

Pie diagram



Histogram

- The area of each rectangle representing the frequency.
- Height of each rectangle equals the frequency of the class interval divided by the class width

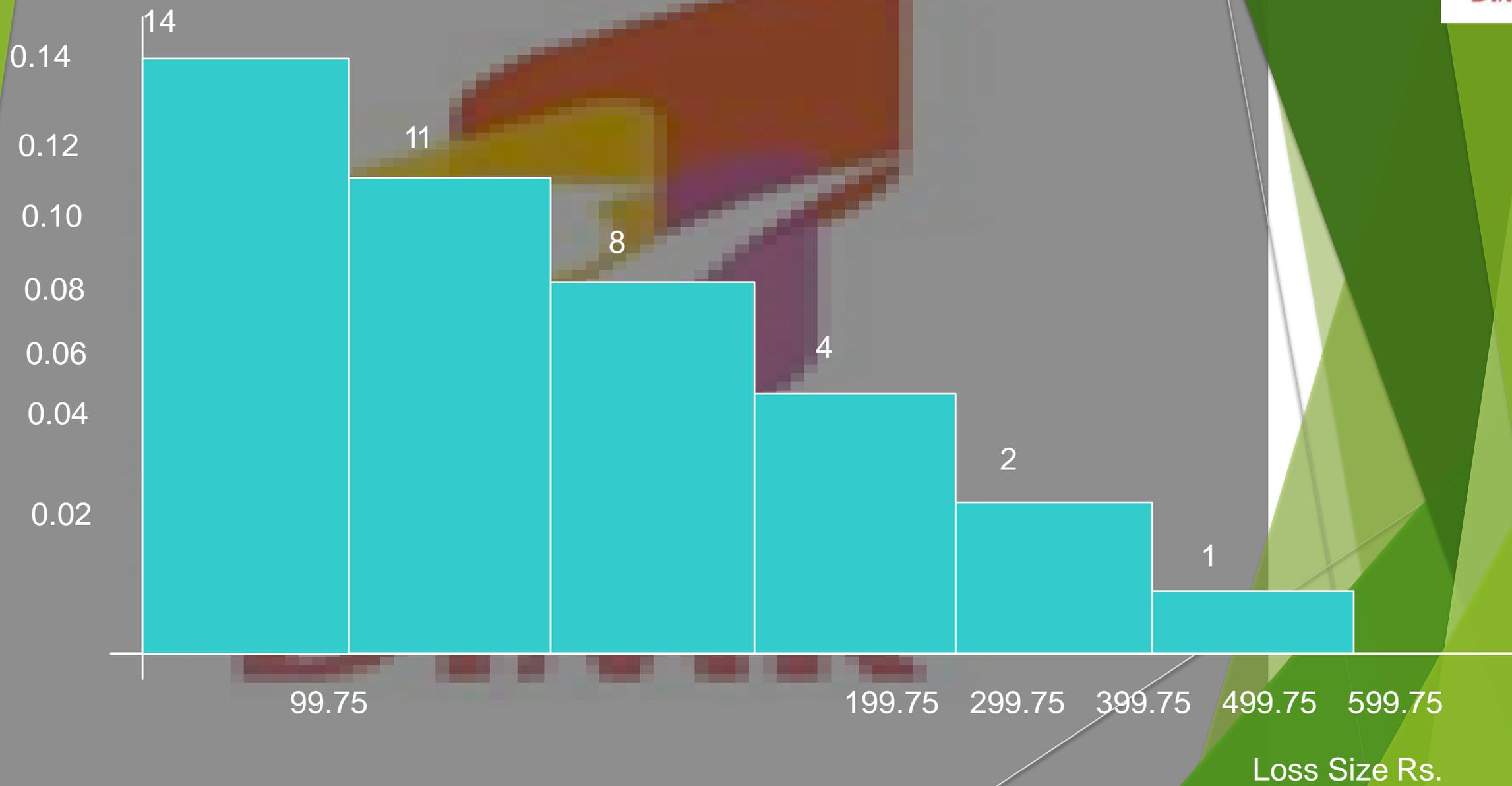
DIMR

Fire material damage loss data

Class interval Rs.	Class frequency	Class Width Rs.	Height of histogram rectangle
0-99.5	14	100	$14/100=.14$ units
100-199.5	11	100	$11/100=.11$ units
200-299.5	8	100	$8/100=.081$ units
300-399.5	4	100	$4/100=.04$ units
400-499.5	2	100	$2/100=.02$ units
500-599.5	1	100	$1/100=.01$ units

DIMMR

Frequency
Class Width



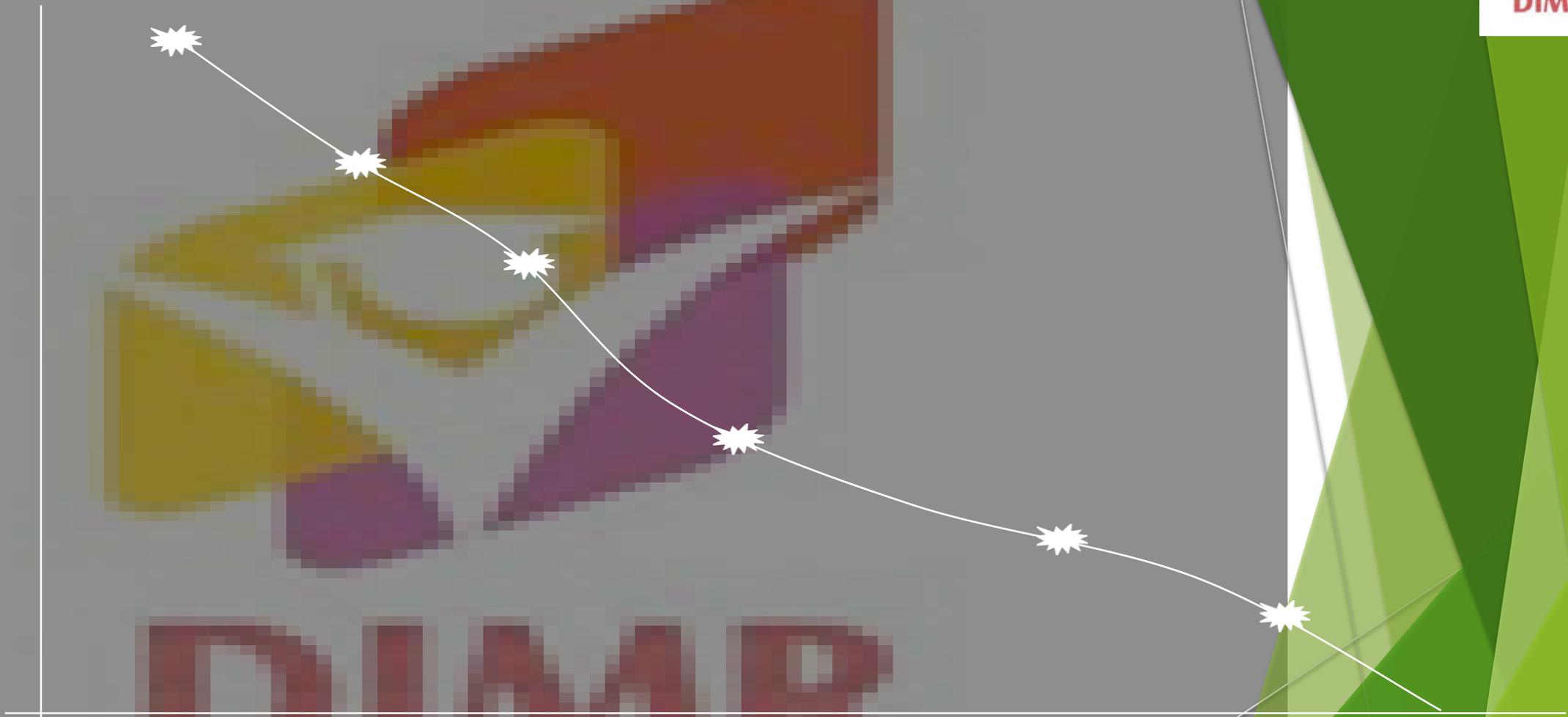
Frequency Polygon (curve)

- Drawing straight line connecting the mid-points of each class interval along the top of the rectangles



Frequency
Class Width

0.14
0.12
0.10
0.08
0.06
0.04
0.02



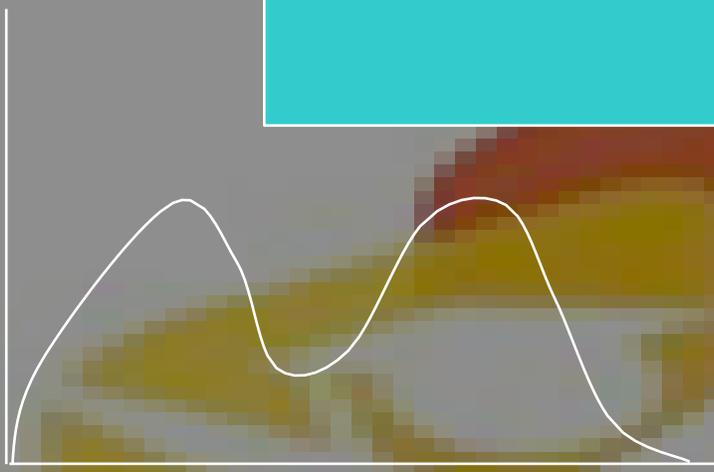
49.75 149.75 249.75 349.75 449.75 549.75

Loss Size Rs.

Frequency Curves

(a)

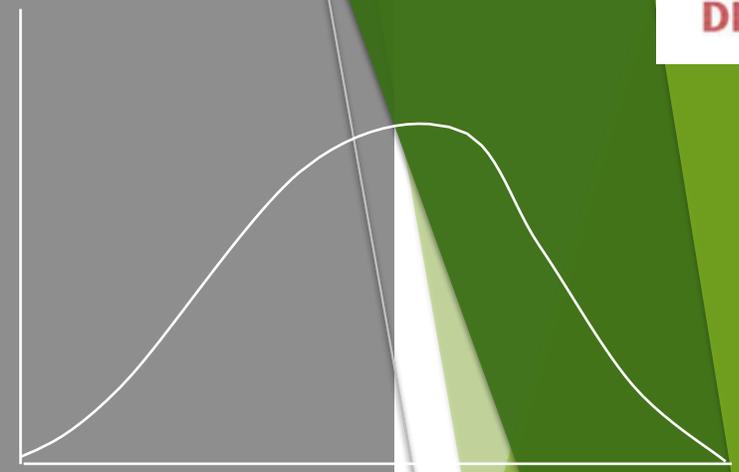
Frequency



Size of employers
Liability Loses (Rs.)

(b)

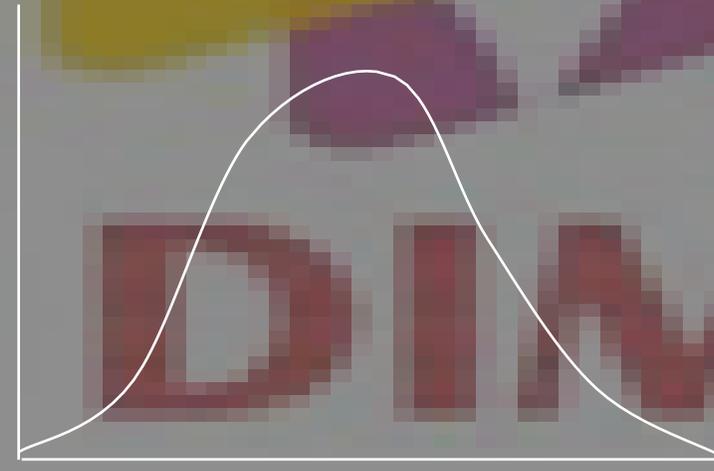
Frequency



No. of Defective goods
produced in a week

(c)

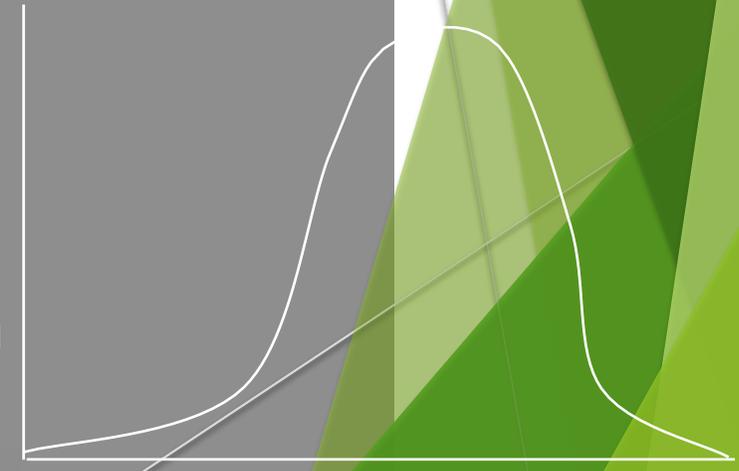
Frequency



Size of employers
Liability Loses (Rs.)

(d)

Frequency



Size of earthquake
Losses (Rs.)

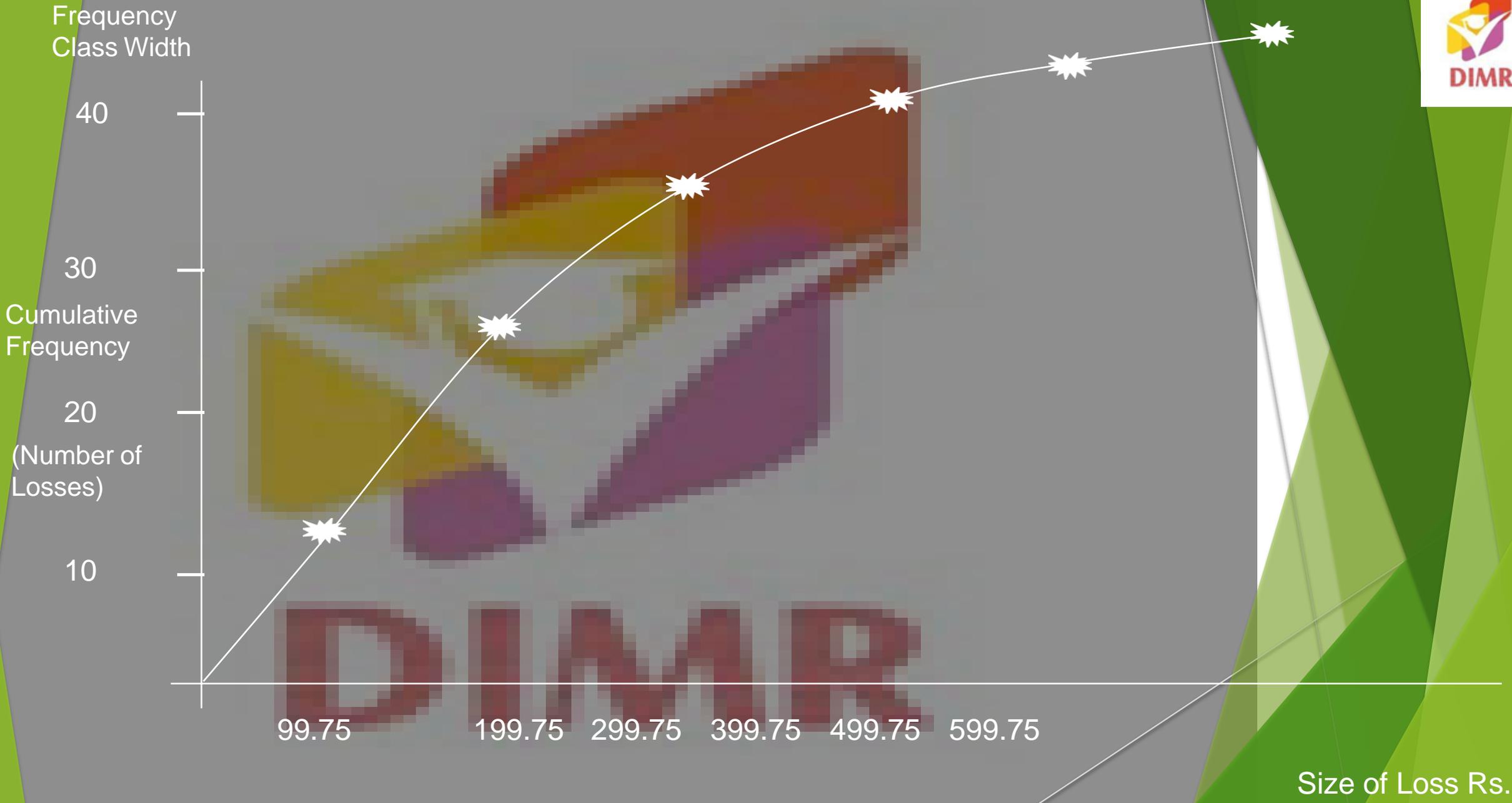
(Damage to individual property
within a 5 mile radius of scale
earthquake expressed as % of total
value)

Cumulative Frequency Distribution

Fire loss data : A fire insurance company incurred 46 incidents last year distributed by claims cost as follows:

Size of fire loss Rs. Class frequency Cumulative frequency

0-99.5		14	14
100-199.5		11	25
200-299.5		10	35
300-399.5		06	41
400-499.5		03	44
500-599.5		<u>02</u>	46
		46	



Workmen's compensation payment probability

Total Claims per year

(f) Likelihood

Probability

Rs.	0	150	0.150
Rs.	500	430	0.430
Rs.	1,000	250	0.250
Rs.	2,500	100	0.100
Rs.	5,000	45	0.045
Rs.	10,000	20	0.020
Rs.	25,000	04	0.004
Rs.	50,000	01	0.001
		1000	Total 1.000

The probability distribution indicates that most likely losses remained around Rs.500 which can be expected 43% of the population

Number of days it takes to settle a house hold insurance theft claim

Time taken to settle claim in days	Frequency (f)	fx
(x)		200
	20	
10	30	600
20	40	1200
30	10	400
40	4	200
50		2600
Total	104	

Mean = $2600 / 104 = 25$ days is the average time taken to settle a house hold insurance claim

Days lost due to machinery breakdown at a factory in last 13 Years



<u>Year</u>	<u>Days Lost</u>		
1	7		
2	23		
3	0		
4	10		
5	34		
6	47	Mode	
7	18	Median	
8	0		
9	9		
10	11		
11	29		
12	15		
13	20		
<u>Total 223</u>		<u>Mean=223/13=17.5</u>	The above data is

not sufficient to develop a detailed probability distribution

Central tendency (Clustering)

- Most probability distributions tend to cluster around a particular value, which may be middle of the range of the possible values the distribution covers
- Mean, Median and Mode are used to identify such values
- Arithmetic mean is the average out of the number of days lost- $223/13=17.5$; median is middle number-18; mode is the number most repeated
- The arithmetic mean of a probability distribution is computed much like the arithmetic mean, the only difference is that instead of dividing by the number of items, each item in the probability distribution is multiplied by its respective probability and sum of these products is divided by the sum of the probabilities

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The arithmetic mean of a probability distribution- Workmen compensation

Total Claims per year	Probability	Cumulative frequency	
(X)	(P)	(PX)	
Rs. 0	0.150	Rs. 0	
Rs. 500	0.430	215	
Rs. 1,000	0.250	250	
Rs. 2,500	0.100	250	
Rs. 5,000	0.045	225	
Rs. 10,000	0.020	200	
Rs. 25,000	0.004	100	
Rs. 50,000	<u>0.001</u>	<u>50</u>	
	Total 1.000	\sum PX Rs. <u>1,290</u>	/1 = Arith. Mean

The expected annual total of workmen's compensation claim for the given firm is **Rs. 1290 (EXPECTED VALUE)**

Expected value

- Arithmetic mean represents long-run average expectations
- Arithmetic mean of a probability distribution usually referred to as the expected value of that distribution
- Expected value of a probability distribution provides information about where the outcomes tend to occur, on average. It is expected loss in the example.
- In the given example on an average the workmen compensation claims are Rs. 1290 per annum. It shall help the risk manager to pay premium price for any year.
- Median of a distribution is the value in the middle, when the numbers are arranged in ascending order
- Mode of distribution is the single value which is most likely to occur

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Dispersion (variability)

- Should the mean be treated as a guide to understand the probability of loss in future ? Or further studied to find out the correctness of the decision by analysing how far the losses that took place were near to mean
- The study of probability distribution indicate two characteristics—
 - Central tendency or clustering
 - Dispersion or variability (from the point around which the distribution clusters)

DIMR

Dispersion (variability).....

- The less the dispersion around the expected value of a distribution, the greater the likelihood that actual results will fall within a given range of the expected value.
- The less the dispersion or variance, there is less risk in prediction
- Variance measures the probable variation in outcomes around the expected value.
- A high variance implies that outcomes are difficult to predict.
- Measure of dispersion or variance- Standard deviation of the distribution and other is the coefficient of variation

DIMR

Year	Days Lost	Difference from Mean	Square of Difference (variance)
1	7	-10	100
2	23	6	36
3	0	0	0
4	10	-7	49
5	34	17	289
6	47	30	900
7	18	1	1
8	0	17	289
9	9	-8	64
10	11	-6	36
11	29	12	144
12	15	-2	4
13	20	3	9
Standard Deviation = $\frac{223}{13} = 17$ (Mean) Variation = $\frac{1,921}{(13-1)} = 160.083$ = $\sqrt{160.083} = 12.6$ days approx.			

is very high.

Standard deviation

- The variance of a probability distribution provides information about the likelihood and magnitude by which a particular outcome from the distribution will differ from the expected value.
- The more is the variance, the more is the uncertainty about the expected value
- Square root of variance is called Standard deviation

DIMR



Claims
(X)

Probability (P)
(P)

(X-E)*

(X-E)²

P(X-E)²

Rs.	RRs.			
0	0.150	0.150	-1,290	1,664,100
500	0.430	0.430	-790	624,100
1,000	0.100	0.100	1,210	13,764,100
2,500		0.100	1,210	1,464,100
5,000	0.100	0.045	3,710	13,764,100
10,000	0.045	0.020	8,710	75,864,100
25,000	0.020	0.004	23,710	562,164,100
*Expected Value=		1290		

Standard Deviation = 18,853,272.6 = Rs.4,342 approx.

Standard deviation provide a measure of the variability of these distributions

Coefficient of variation = Standard Deviation/ Arithmetic mean

Application

- Severity is very important, a single cat loss could wipe out the firm.
- **Maximum possible loss-** worst loss that could happen to the firm during its life time
- **Maximum probable loss-** worst loss that is likely to happen
- **Risk manager has to analyze cost effectiveness while using any RM technique.** For examples:
 - While taking a policy:
 - Premium cost
 - Service charges by Ins. Co./Broker
 - Probable average loss
 - Possible variance
 - While opting for voluntary deductible
 - Premium saving exceeds the average loss
- While investing on loss preventive measures, like-
 - purchase cost of Fire Fighting equipment and
 - the saving in premium in consequence thereof.

Probable Maximum Loss

- An estimate of the monetary loss which is likely be suffered by the insurer on a single risk at any one point of time, e.g. as a result of a single fire or explosion

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Probable Maximum Loss

- It is more of a subjective phenomenon.
- Depends upon:
 1. Technical info about the risk.
 2. Contribution made by each block to the gross profit of the org.
 3. Type of coverage given by the insurers.
 4. Past loss experience.
 5. Physical inspection of risk.

Probable Maximum Loss

Advantages of PML

1. Placement of reinsurance contract.
2. Whether to retain or transfer.

Disadvantages of PML

1. Subjective phenomenon
2. Requires experts
3. Requires periodic revision.

Risk management decisions

- To decide over the **probability of loss** in future with the help of stat-analysis
- What shall be the **cost of loss control measures** to be adopted and to what extent the average loss shall be reduced
- What is the **cost of premium and related costs** in comparison to average loss
- What shall be the **capacity of business to sustain** a loss by self to decide about the excess applied by Insurance or voluntary excess to be adopted

Decision taking under conditions of Risk and Uncertainty

- Risk manager has to take a decision from the various decisions/options
- A decision can have more than one outcome, the result are not known (uncertainty)
- Manager may also unable to find out various outcomes
- Decision theory is based on various techniques adopted by the manager to deal with different categories of uncertainty
 - Pure uncertainty
 - Risk
 - Competitive uncertainty

Decision taking under Pure Uncertainty

- **Pure uncertainty**
- When all possible outcomes to a decision are known (probability is not known)
- But knowledge of which one will occur is absent
- **Risk**
- When outcomes are known and probability of each occurring can be assessed
- Risk comes in selecting the strategy/ scheme
- **Competitive uncertainty**
- Decisions after knowing that Rivals using strategy to minimise the gains

Decision making under Pure Uncertainty.....

- Pure uncertainty exists when the manager can specify all the possible outcomes of different strategies but has uncertainty of which one will occur (probability of the outcomes is not certain)
- Manager has to decide about the various options or strategies and the outcomes as resultant of those strategies
- Cost of 3 Risk Retention Scheme – Pay-Off Matrix(Rs.000)
- Cost of 3 Risk Retention Scheme – Pay-Off Matrix(Rs.000)

Risk Retention Scheme	Claims Experience in next 5 yrs- Expected (Rs.000)		
	High	Medium	Low
A	26	7	0
B	15	14	6
C	10	10	10

Minimax criterion

- Decision criteria which may be applied depending upon **manager's attitude** towards retention of risk
- A **pessimist** or risk averter will assume worst possible result would occur or highest cost in this case
- He shall choose scheme A expecting a high claim experience costing Rs.26,000
- Minimax criterion- minimum out of Max. –
- As per the High claim experience table given below, the manager shall choose scheme C with minimum cost Rs.10000 in minimax criterion

Scheme	High Cost of Rs.000s
A	26
B	15
C	10

Minimum Criteria

- An **optimistic manager** who can take a risk, would always expect the best to happen and shall opt for the low claim experience
- He would choose scheme A with minimum cost under minimin criterion

Scheme	Low Cost of 000s
A	0
B	6
C	10

Shortcomings in both the criterions:

- It is assumed that the risk attitude of the manager is either risk averse or risk preferer
- The intermediate or medium values of the pay off (claims) was ignored

Coefficient of Optimization

- Out of those shortcomings, the first one about extreme attitude of risk manager can be overcome by taking **weighted average** of the results
- A decision maker shall choose a number between 0 to 1 indicating his risk attitude
- An optimistic manager shall choose higher coefficient as .80 or 4/5 and thereby the expected pay offs for each strategy shall be as under:

Scheme	Minimum cost		Maximum cost		Expected Pay-Off Rs. '0000
A	$0 \times \frac{4}{5}$	+	$26 \times \frac{1}{5}$	=	5.2
A	$0 \times \frac{4}{5}$	+	$26 \times \frac{1}{5}$	=	5.2
B	$6 \times \frac{4}{5}$	+	$15 \times \frac{1}{5}$	=	7.8
C	$10 \times \frac{4}{5}$	++	$10 \times \frac{1}{5}$	=	10.0

The optimistic manager would choose **scheme A** which has the lowest expected cost

Insufficient Reason Criterion

The second criticism of ignoring intermediate values of the pay offs.

- In the absence of knowledge about the probability of each event, all the events from high to low claim experience in all strategies, shall be deemed to happen
- The payoff for each scheme is then the average payoff in each row as calculated under:

Scheme	High	Medium	Low		Expected Pay-Off Rs. '000
A	$26 \times \frac{1}{3} +$	$7 \times \frac{1}{3} +$	$0 \times \frac{1}{3}$	=	11.000
B	$15 \times \frac{1}{3} +$	$14 \times \frac{1}{3} +$	$6 \times \frac{1}{3}$	=	11.677
C	$10 \times \frac{1}{3} +$	$10 \times \frac{1}{3} +$	$10 \times \frac{1}{3}$	=	10.000

In this case **scheme C** would be chosen. This method takes no account of decision maker's risk attitude.

Minimax Regret Criterion

The risk manager does not want to regret on the choice of scheme he has opted, and therefore examine the results of another choice. Regret is measured as the absolute difference between the pay-off for chosen strategy and the pay-off for the most effective strategy with the same state of nature

Risk Retention Scheme	Claims Experience Rs.000		
	High	Medium	Low
A	26-10=16	7-7= 0	0
A	26-10=16	7-7= 0	0
B	15-10= 5	14-7= 7	6
B	15-10= 5	14-7= 7	6
C	10-10= 0	10-7= 3	10
C	10-10= 0	10-7= 3	10

Scheme	Cost of 000s
A	16
B	7
C	10

Decision making Under Risk

Risk Retention Scheme	Claims Experience (probability is known)		
	High Probability 0.5	Medium Probability 0.3	Low Probability 0.2
A	30	10	50
B	40	30	20
C	20	20	30

The expected Value of each scheme is as follows:

Scheme A : $30 \times 0.5 + 10 \times 0.3 + 50 \times 0.2 = \text{Rs. } 28,000$

Scheme B : $40 \times 0.5 + 30 \times 0.3 + 20 \times 0.2 = \text{Rs. } 33,000$

Scheme C : $20 \times 0.5 + 20 \times 0.3 + 30 \times 0.2 = \text{Rs. } 22,000$

Here B should be chosen for having highest expected value.

Subjective Probability

- Decisions are based on the probabilities of outcomes, derived from statistical data
- But it is not always possible to arrive at a decision due to lack of sufficient statistical data
- A subjective decision is taken by risk manager depending upon the degree of confidence to judge probabilities of different events based on his experience and whatever historical data available

Subjective Probability.....

- According to the degree of belief for the possible occurrence of an event, the risk manager assigns a probability between 0 to 1
- The experience of similar firms or organizations may also be examined
- All the available facts and data must be collected and expert opinions may be sought for by the risk manager

DIMR



Save Tax

Grow Your
Money

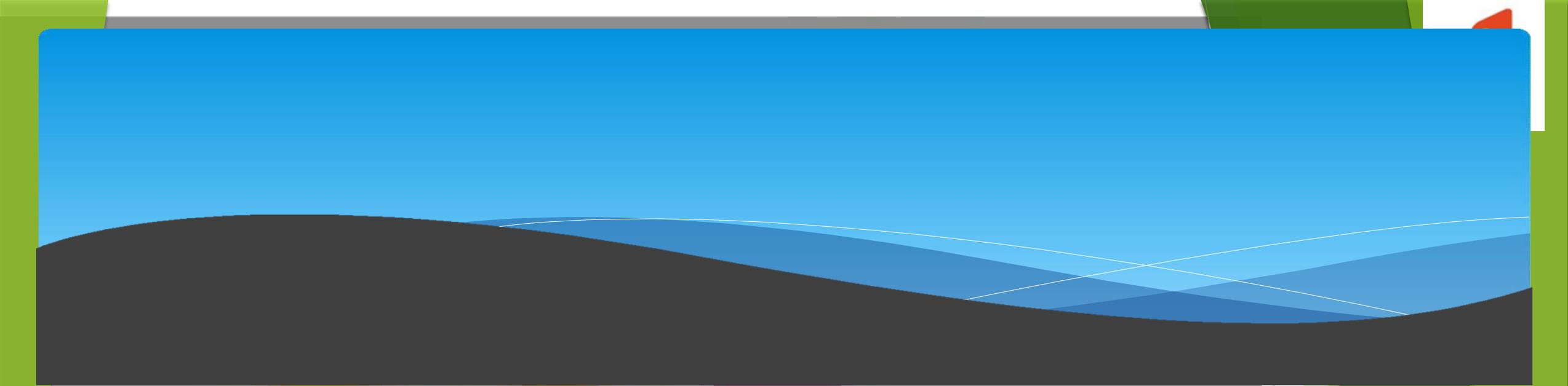
Tax

Planning

www.fox.com

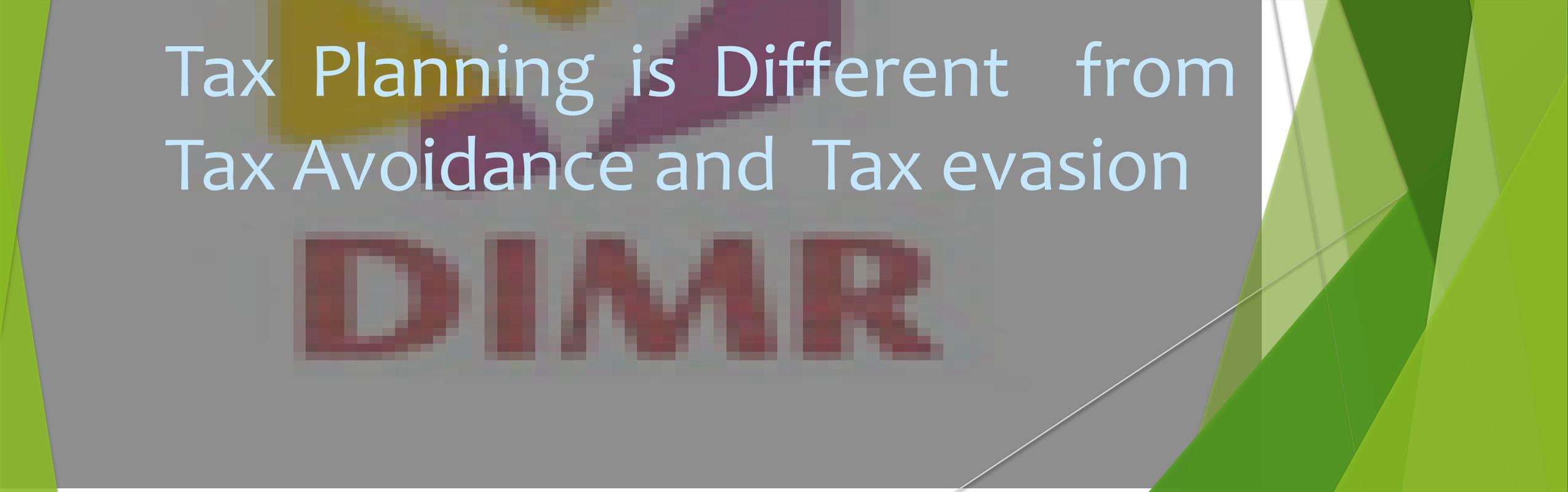
What is Tax Planning?

- * Tax planning is the analysis of one's financial situation from a tax efficiency point of view so as to plan one's finances in the most optimized manner.
- * Tax planning is an exercise undertaken to minimize tax liability through the best use of all available allowances, deductions, exemptions etc to reduce income or capital gains.
- * Tax planning is a legal way of reducing income tax liabilities



Tax Planning is Different from
Tax Avoidance and Tax evasion

DINAR



Tax Planning Objectives:

- * Reduction in overall tax liability
- * Economic stability
- * Growth of economy
- * Litigation minimization
- * Productive investment.

DIMR

Types of Tax Planning:

- * **Purposive tax planning:** Planning taxes with a particular objective in mind
- * **Permissive tax planning:** Tax planning that is under the framework of law
- * **Long range and Short range tax planning:** Planning done at the start and end of a fiscal year respectively.

Types of Assesses

- * Individuals
- * Hindu Undivided Family
- * Company
- * Firm Association of persons
- * Local authority
- * Other persons not included above

Heads of Income

- * Income from Salary
- * Income from House Property
- * Profits and Gains from Business
- * Capital Gains
- * Income from Other Sources

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Tax Planning in India

- * Save tax under Sec 80 c, Sec 80 ccc & Sec 80 ccd
- * Save tax under Sec 80D, Sec 80 DD & Sec 80 DDB
- * Tax Planning through Home loan
- * Save Tax Through Education Loan u/s 80E
- * Tax Planning of long term Capital Gains
- * Income Tax Deductions for Donations u/s 80G
- * Long term Capital Gains from the Sale of Equity Shares.

PART I: Income Tax Slab for Individual Tax Payers & HUF (Less Than 60 Years Old) (Both Men & Women)

Income Slab	Tax Rate
Income up to Rs 2,50,000*	No tax
Income from Rs 2,50,000 – Rs 5,00,000	5%
Income from Rs 5,00,000 – 10,00,000	20%
Income more than Rs 10,00,000	30%

Surcharge: 10% of income tax, where total income exceeds Rs.50 lakh up to Rs.1 crore.

Surcharge: 15% of income tax, where the total income exceeds Rs.1 crore.

Cess: 3% on total of income tax + surcharge.

PART II: Income Tax Slab for Senior Citizens (60 Years Old Or More but Less than 80 Years Old)(Both Men & Women)

Income Slab	Tax Rate
Income up to Rs 3,00,000*	No tax
Income from Rs 3,00,000 – Rs 5,00,000	5%
Income from Rs 5,00,000 – 10,00,000	20%
Income more than Rs 10,00,000	30%

Surcharge: 10% of income tax, where total income exceeds Rs.50 lakh upto Rs.1 crore.

Surcharge: 15% of income tax, where the total income exceeds Rs.1 crore.

PART III: Income Tax Slab for Senior Citizens(80 Years Old Or More) (Both Men & Women)

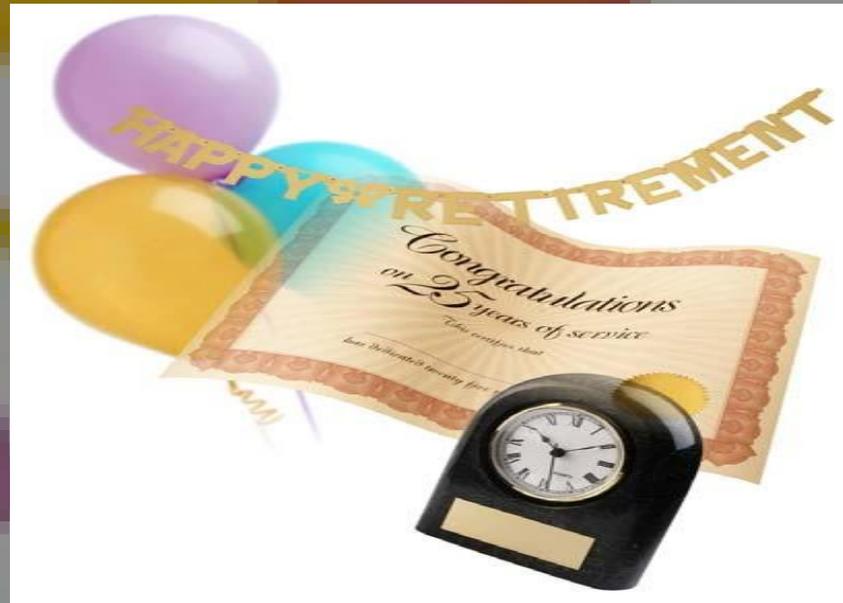
Income Slab	Tax Rate
Income up to Rs 2,50,000*	No tax
Income up to Rs 5,00,000*	No tax
Income from Rs 5,00,000 – 10,00,000	20%
Income more than Rs 10,00,000	30%

Surcharge: 15% of income tax, where total income exceeds Rs.1 crore.

Tax Saving Investments

- * Equity Link Saving Scheme
- * Public Provident Fund
- * Employee's Provident Fund
- * Unit linked Insurance Plan
- * Traditional Insurance Plan
- * National Pension Scheme
- * 5 years Post Office Time Deposits

Module 3



Retirement Planning

At the end of this session, you will understand



- Retirement and the importance of retirement planning
- Wealth Creation
- Retirement benefits
- Retirement Planning strategies
- Pension Sector reforms

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Introduction to Retirement Planning

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What is retirement?

- Simply put, it is that period of life when an individual is no longer working or at the commencement of such a period.
- According to a Harvard Study, it is worrying under the following 4 circumstances:
 - When it is unplanned and involuntary
 - When the wage or salary is the only means of income
 - When one's home life is unhappy and work has provided an escape.
 - When there is pre-existing bad health.

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Exercise 1

- What according to you are the questions that gain prominence after one's retirement?



Why Retirement Planning

- Inflation rates and the cumulative effect of inflation ensures that you will need more money for your retirement. You need to find out where this income will accrue from.
- You need to plan your goals and lifestyle that you would want to pursue post retirement.
- You will need to ensure that you have an adequate life and health insurance cover to provide for illnesses that are inevitable at this stage of life.

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Importance of Retirement Planning

- To help you maintain the required lifestyle.
- To ensure self-sufficiency at retirement.
- Provide for emergencies

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Retirement Planning Process

- Main aim of retirement planning is to ensure that this period of life is not stressful for you or your family.
- The retirement planning process consists of the following steps:



Sources of retirement Income



Government



Company Retirement Program



Your Investments

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Current Scenario

- Traditional modes of earning retirement income such as pensions and provident funds do not provide you with enough funds for a comfortable retirement.
- The interest rates on Employee's Provident Fund has reduced from 12 % to 8.5 %
- The growing inflation rates or effect of cumulative inflation growth over the years will eat into the purchasing power of your savings.

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Current Scenario...

- *The life expectancy at birth has increased to nearly 64 years as per the 2001 census.*
- *Males and females in India at age 60 today are expected to live beyond 75 years of age meaning that they have to provide for themselves for another 15 years*
- *On an average you will need to have adequate resources to support you & your spouse for 15 years after retirement.*

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Combating Inflation

- The increasing inflation rate and the cumulative effect of inflation is always eating into the purchasing power of your money.
- Your investments have to earn more than the inflation rate, for you to get a real return on your investments.
- You need to plan for this eventuality as well.

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How do you start planning for your retirement?

This list can help you strategize and create a good retirement plan:

- Create an Emergency Fund
- Set Your Retirement Savings Goals
- Maximize Workplace Savings
- Establish an IRA and a Spousal IRA
- Establish an Automatic Investment Program for Your IRA
- Save in Taxable Investments
- Review Your Asset Allocation

What is an Individual Retirement Account (IRA)?

- A new pension system envisaged by the Project OASIS report.
- Created by the individual, with a passbook and able to see the balance of notional wealth at a particular point in time.
- Wealth management is done by the individual himself.
- Contributions will be made by the individual throughout the working life and benefits will accrue to him at retirement.

DIMR

Advantages of IRA's

Investment compounds on a tax deferred basis

IRA may be fully tax deductible if you are not eligible to participate in any retirement plan through your employer

You can jointly contribute to 2 IRA accounts in a spousal IRA, even if there is only one wage earner,
and claim deduction for the non earning spouse

You can make contribution Even if your contributing To any workplace Savings plan

Wealth Creation



The roadblocks to financial independence

- Taxation
- Inflation
- Temptation
- Procrastination
- Speculation

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Retirement Age

- The age at which you retire or choose to retire can have a substantial impact on your retirement plans.
- Three Possibilities:
 - Full Retirement Age
 - Early Retirement
 - Delayed Retirement

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Retirement Age

- **Full Retirement Age:** This option is helpful if the individual had an average salary earnings throughout the working life. In this scenario, the benefits received in the first year of retirement will suffice for the retirement period.
- **Early Retirement:** In this scenario, the retirement corpus will be permanently reduced and the individual would be getting lesser benefits even after reaching the normal retirement age.
- **Delayed retirement:** This benefits you in two ways:
 - Additional years of earning income
 - Better benefits at the time of retirement.

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Inflation

- **Public enemy number 1!**
- **Can have a huge impact on the purchasing power of money.**
- **Even if inflation is absent, the cumulative effect of past inflationary trends will continue to eat into your savings.**
- **You need to ensure that your earnings on investments are more than the inflation rate to ensure that the real value of your money is more.**

DIMR

Planning for Inflation

- Remember, it's here to stay. And it varies from year to year.
- You can safely assume an inflation rate of 3-4 % in the current economic environment, while planning for your retirement.
- Save as much as you can to cut down the shortfall caused due to inflation.
- If you can, reduce your standard of living to further cut down the shortfall.
- If you are still young, you should invest in the stock market that offers fluctuating rate of interest which will be higher than fixed income yielding securities.

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How much money will you need after retirement?



According to experts you will need between 70% & 90% of your current income, adjusted for inflation, to live comfortably after retirement.

Retirement Benefits



What are retirement benefit schemes?

- Schemes operated or sponsored by the state, employers or a group of employers.
- Good Retirement plans will have the following characteristics.
 - Provide regular income after retirement
 - Lumpsum payment at retirement
 - Take care of effects of inflation
 - Meets medical exigencies.

Types of Benefit Plans

Defined Benefit Plans

- Usually based on the employees final salary and period of employment.
- Employees contribute at a fixed rate and the employer meets the balance costs.
- The cost of such a scheme is not known till the benefits have been paid.

Defined Contribution plans

- The contribution rate is a percentage of earnings or may be flat or tiered on some other consideration
- The contribution of both the parties is fixed.
- The benefits to the employee would depend on the value of the accumulated contributions.

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Advantages

Defined Benefit

- Guaranteed retirement income security for workers
- No investment risk to participants
- Cost of living adjustments
- Not dependant on the participant's ability to save
- Tax deferred retirement savings medium

Defined Contribution

- Tax deferred retirement savings medium
- Participants have a certain degree of how much they choose to save
- Can be funded through payroll deductions
- Lump sum distributions may be eligible for special 10 year averaging
- Participants can benefit from good investment results
- Easily understood by participants

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Disadvantages

Defined Benefit Defined Contribution

- Difficult to understand by participant
- Not beneficial to employees who leave before retirement
- Difficult to build a fund for those who enter late in life
- Participants bear investment risk
- Annual employee salary reductions is limited

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Implications of Pension Plans

- **Employer's Perspective**
- Employer will need to control the level of the costs involved in providing the benefits. However, the employer will also have needs relating to the timing of costs and to non- finance related matters.
- There are several recurring elements to controlling cost.
- These include:
 - value for money
 - predictable costs
 - stable costs
 - flexible contribution programmes, if the scheme is funded.

Implications of Pension Plans

- The needs of an employer sponsoring benefit provision will reflect the culture of the company concerned and the priorities of the employer
- An employer will have a number of objectives, both financial and non-finance related, which need to be balanced.
- These are:
 - Attract and retain the right staff.
 - Tax Efficiency
 - Financial needs

Implications of Pension Plans

- **Employee's Perspective:**
- **An employee would always like to maximize the benefit.**
- **Every employee will also aim at maintaining a certain standard of life after retirement, which generally is not significantly different than that in before the retirement.**

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Defined Benefit Plans

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Defined Benefit Plans

- *Gratuity and the Payment of Gratuity Act 1972*
- *Leave Salary*
- *Retrenchment Compensation and the Industrial Disputes Act 1947*
- *Voluntary Retirement Scheme*
- *Nature of Defined Benefits & Tax Issues*

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Gratuity

- Gratuity is a lump sum payment made on retirement of an employee.
- Payment of a gratuity is mandatory for an organisation employing more than nine employees in any financial year.
- The Gratuity Act of 1972 specifies the rate of 15 days wages per year of service.
- A gratuity is payable immediately upon the termination of employment for superannuation, retirement, or resignation after an employee has completed at least five years of continuous service which is not necessary in the case of death or disablement.
- The amount of the gratuity shall not exceed Rs. 350,000. Any amount in addition to the prescribed limit is taxable in the hands of the recipient.

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Tax Aspects

- The gratuity amount is not added to an employee's income for tax purposes. Funding of the gratuity liability carries certain tax incentives.
 - Contributions paid by the employer are deductible as a business expense.
 - Funding of the past-service liability by the employer in up to five annual installments is also allowed as a business expense in the year of payment.
 - Contributions (or premiums in case of an insured gratuity scheme) are not taxed as income for the employees.
 - Investment income (whether interest or capital gains) of the gratuity fund is not liable to tax.

Leave Salary

- Under this benefit, the employee gets cash payment for surrendering his un-utilised leave that he has accumulated. However, this is subject to certain conditions.
- The quantum of leave usually depends upon negotiated settlements between the employer and employees' representatives or on the employer's policy in this behalf
- The employer also puts in place a system for the encashment of leave. Some employers allow such encashment only at the time of leaving the service, (retirement, death or resignation) and some employers allow even while in service.

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Tax Implications

- Cash equivalent of leave salary payable to a government employee in respect of leave to his credit at the time of his retirement on superannuation or otherwise, is free from tax.

For other employees, this exemption is subject to the least of -

- 10 months average salary (calculated on the basis of the salary during 10 months preceding the employees' retirement on superannuation or otherwise).
- Cash equivalent of leave salary in respect of the period of earned leave standing to the credit of the employee. Earned leave cannot exceed 30 days for every year of actual service rendered for the employer from whose service he has retired.
- The amount of leave encashment actually received.
- Rs. 3 lakhs.

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Retrenchment Compensation

- A workman is entitled to compensation (which is almost similar to Gratuity in calculation) in case of retrenchment by the employer.
- Similarly, compensation is payable in case of closing of an undertaking or transfer of an undertaking whereby the workman would be retrenched.
- The financial compensation will be equal to 15 days' wages for each completed year or part thereof in excess of six months of service put in by the workman with the employer.

VRS- Voluntary Retirement Scheme

- If an employee seeks to retire on his own volition during an agreed period of years before attaining the age of superannuation, the employer would treat his exit from the service as retirement for all practical purposes rather than as resignation.
- Thereby the employee would be entitled to all the benefits that are available to an employee who retires on attaining the normal age of superannuation.

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Defined Contribution Plans

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Defined contribution plans

- Statutory Provident Fund
- Recognised Provident Fund
- Unrecognised Provident Fund
- Employees' Pension Scheme
- Employees' Deposit Linked Insurance Scheme
- Public Provident Fund

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Provident Fund

Types of Provident Funds

Statutory PF

- Maintained by government and semi-government organizations, local authorities, universities etc.
- Everything is exempt from tax, without any ifs and buts, including the employer's contribution and the interest paid, even if it is over 12%.

Recognized PF

- Applicable to establishments with 20 or more employees.
- The PF Commissioner manages the funds.
- If the establishment desires to manage the funds, they can do so by creating a trust approved by the IT commissioner and invest according to the PF rules.

DIMR

Provident Fund

Types of Provident Funds

Un Recognized PF

- Not approved by the IT Commissioner is a bad baby deserving heavy punishment.
- If the number of employees is less than 20, the Commissioner finds it inconvenient to account. handle this small PF
- The employer does not have the wherewithal to establish a trust and follow the investment norms.
- Employee's contribution does not qualify for deduction u/s 80 C!
- The employer's contribution and interest thereon are brought to tax as profits in lieu of salary in the year when the payment is made. Interest on employee's own contribution is taxable u/s 56 as Income from Other Sources.

Employees Deposit Linked Insurance Schemes

- Is applicable to all factories/establishments with effect from August 1, 1976.
- All the employees who are members of the Employees' Provident Fund are required to become members of this Scheme.
- Employers are required to pay contributions to the Insurance Fund at the rate of 0.5 per cent of pay i.e. basic wages, dearness allowance including cash value of food concession and retaining allowance, if any.

Public Provident Fund

- The Public Provident Fund scheme is a statutory scheme of the Central Government framed under the provisions of the Public Provident Fund Act, 1968.
- This is an annuity with a term of 16 years. 8% per annum w.e.f. 01-03-2003 credited in account on 31st March every year calculated on minimum balance between 5th day and end of the month.
- An individual can open only one account in his/her name either in Post office or in Bank
- It is not necessary to deposit subscription in every month of the year

DIMR

Public Provident Fund

- The amount standing to the credit of the subscriber in the fund is totally exempt from Wealth Tax.
- A non-resident Indian can open a PPF account out of moneys in the applicant's non resident account in India in banks, subject to certain conditions.
- The contributions to PPF are eligible for rebate u/s 80 C. Ceiling on annual contributions to PPF was raised from Rs. 60,000 to Rs. 70,000 by Notification GSR768(E) dt. 15.11.'02.

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Public Provident Fund

- Beginning from the seventh year and every year thereafter, an account holder is entitled to withdraw 50% of the balance to his credit at the end of the fourth or the first previous financial year, whichever is lower.
- The account can be closed on completion of the term or it can be continued for a block of 5 years. This facility is available for a further block of 5 years on expiry of 20 years and yet another 5 years on expiry of 25 years and so on for any number of blocks.

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Superannuation and other retirement plans

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Superannuation and other retirement plans



- Trust funds – fiduciary responsibilities
- Approved superannuation funds
- Employer pension plans and applicability to client
- Private fund managers, investment norms
- Pension plans from mutual funds and insurance companies
- Social security benefits – civil servants, defense personnel and war widows, agricultural workers, destitutes, disaster affected people, etc.
- Retirement plans for self-employed
- Profit sharing plans

Superannuation

- An organizational pension program created by companies for the benefit of their employees.
- Funds will typically grow without any tax implications until retirement or withdrawal.
- Two types:
 - Defined Benefit- defines the amount of benefit that the participant will get on retirement
 - Defined Contribution- defines the annual contribution that the employer will deposit into the plan on behalf of each participant.

Need for Superannuation

- Retirement should be a time for relaxing, a time to enjoy and forget about work.
- Inflation makes things more expensive as time goes by.
- People need enough money at the time of retirement- for medical expenses, to take up a pleasurable activity and so on.
- Superannuation takes care of this and helps ensure a comfortable retirement.

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Advantages of Superannuation

To employer

- Recruit and train quality staff
- motivate employees & enhance company image
- make provision for long service and severance payment and enjoy tax- deductible benefits.

To employee

- Gets a better retirement benefit.
- In case of death, the pension is payable on the life of the beneficiary, which is tax free.
- Can be withdrawn after a specific period of time.

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Tax Advantages of Superannuation



Employer: Employee

- The maximum contribution an employer can make to the pension fund and provident fund is restricted by the Income Tax Act to 27% of the annual salary.
- The annual contributions are treated as deductible business expenses.
- The Contributions paid by the employer are not treated as perquisites in the hands of the employees.
- The interest on the fund is exempt from tax.
- Benefits payable on death are exempt from tax.
- Commuted value on retirement is tax-free.
- Employees' contribution, if any qualifies for tax exemption under section 80 C of IT act.

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Types of Superannuation Funds

The superannuation scheme can be set up in following three ways:

- Payment by the employer
- Funding through a trust
- Insured scheme

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Types of Superannuation Funds

Payment by Employer:

- In this scheme, payment of money by the employer is paid out as and when they are due out of the current revenue
- The amount required in a particular year to meet such a liability is totally unrelated to his ability to pay and the total annual outlay for payment of such pensions is liable to rise very steeply as the number of pensioners increases. In case of the employer going bankrupt, the employees might not get any benefit.
- The type of superannuation scheme is not allowed in India

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Types of Superannuation Funds

Trust Funds:

- In this scheme of superannuation, a trust is set up for funding the pension liabilities.
- All contributions from employers and employees are transferred to the fund.
- The trust is irrevocable and distinct from the employer, managed by the Trustees exclusively appointed for the purpose.
- It is the responsibility of the trustees to invest the fund in the trust and secure the pension for the members when they are due.

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Types of Superannuation Funds

Insured Scheme:

- Entering into a group superannuation scheme with a life insurance company eases the trustees' task of investing the fund and administering the scheme.
- The insurance company will issue a master policy to the trustee wherein the contributions will be treated as premiums to secure pensions and thus insure, under one contract, all the members of the scheme.
- If the contributions are predetermined, the same will be utilized to purchase the pension. If the pension is determined, then the rate of contribution will be determined on an actuarial basis and the same will be reviewed periodically.

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Private Fund Managers

- Private fund managers may be hired to manage the funds of the trustee administered superannuation funds.
- The superannuation fund may be approved or unapproved.
Approved funds under insured schemes do not require service of private fund managers as the contributions would be remitted to the insurer and the management of the funds is their responsibility.
- Investment of the funds under approved trustee- administered schemes, have to be done in the way prescribed by the Income Tax Act and Income Tax Rules, 1962

Pension Plans from Mutual Funds and Insurance Companies



- An individual, whether employed or not, can also arrange for and sponsor a pension scheme for himself by going for individual pension plans.
- Payment of pension as part of the benefit from the superannuation fund of an employer to the employees or their dependants is coming under the purview of life insurance business as defined by the Insurance Act, 1938. Similarly payment of annuities upon human life is also coming under the purview of life insurance business and hence can be done only by life insurance companies

Pension Plans from Mutual Funds and Insurance Companies



- But payment period of certain annuities (annuities for a fixed term) and building up funds for the retirement using the funds to provide fixed annuities for a certain period can be done by other financial institutions like mutual funds also. These plans will not have any mortality element in the calculation. Hence we have pension products from both Life Insurance Companies and mutual funds available in the market for an individual to choose from.

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Retirement plans for the self- employed

- The self-employed are not covered under specific retirement plan, which would give them a regular income after attaining any specified a
- They have to open a Public Provident Fund account and keep depositing money (with a minimum of Rs.500 / - p.a.) regularly, to get a lump sum payment on completion of 15 years of term.
- The scheme could be extended by periods of 5 years

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Retirement plans for the self- employed

- They can accumulate their savings through public provident funds or other small savings instruments and use the accumulated value of the savings to invest in Monthly Income Schemes available with Post Offices, Banks or Mutual Funds, which would provide them regular monthly income for a specified period.
- In case of self-employed professionals, they can even use the association or the professional body to which they belong, to secure superannuation contract from a Life Insurance Company, which would provide a regular monthly income from their chosen age.

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Profit Sharing Plans

- A Profit Sharing Plan is a retirement plan in which the contributions are made solely by the employer. The business owner has the flexibility to contribute and deduct between 0% and 25% of eligible participant's compensation up to a maximum each year.
- Several allocation methods are available:
 - Same percentage of compensation for each participant
 - Permitted Disparity (Social Security Integration)
 - Age-Weighted

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Advantages of profit sharing plans

- **Allowing discretionary contributions:** the employer can decide what is the amount that he is planning to contribute in a given year depending upon the company's profitability and needs for funds
- **Withdrawal flexibility:** because such schemes are unapproved schemes, he can allow even periodical or discretionary withdrawal of funds by employees while in service.

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Advantages of profit sharing plans

- **Controlling benefit costs:** A defined benefit superannuation scheme could make it extremely difficult for an employer to know in advance what the contribution required for the scheme would be. But here, since the contribution is discretionary, the employer has complete control over the costs of the scheme and hence plan his fund flow accordingly.
- **Providing legal discrimination among employees:** The employer can provide better benefits to good performers via this plan.

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Group Life and health Insurance contracts

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What is Group Life Insurance?

- Group Life insurance covers the lives of multiple persons, such as some or all employees of a business, or members of a labor union, or those owing money to an automobile finance company, or members of an association.
- The person owning the "master group policy" are the employer, the union, the finance company and the association, respectively. The insured persons, whether they get the life insurance as an "employee benefit", or a member benefit "for free", or make a contribution to its cost, or pay for it completely themselves, generally may name their own beneficiaries and are issued "Certificates" that are subject to the underlying Group Life Policy.
- The practical distinction between Individual and Group Life has become more and more blurred as the scope of some groups increases to be so broad to include essentially the population as a whole (the so called "group" of "all people who breath air"), and the face amounts increase, and coverage become more "optional".

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Characteristics of Group Insurance

One can differentiate group insurance from individual insurance on the following points:

- Individual insurance is a contract between individual insured and insurance company. Insurance cover that is granted depends upon the medical, financial underwriting reports and appraisal of risk on the individual. The level premium will remain the same till the end of the contract.

DIMR

Characteristics of Group Insurance

- In case of group insurance, the most important feature is group cover is granted without medical examination and other forms of evidence of insurability.
- The most obvious characteristic that distinguish group insurance from individual insurance is the insuring of a number of persons under single master contract.
- The individuals do not receive a policy but instead receive individual certificates of insurance that serve as evidence of their coverage under the master policy.

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Characteristics of Group Insurance

- The cost of group insurance is lower than the cost of individual insurance as it provides mass protection at low cost. Also the cost of underwriting, administering, selling and servicing group insurance require a smaller percentage of the premium than that of individual insurance contract.
- Administration is economical because insurer deals with a single entity, generally all covered employees are actively at work and deduction from salary provides a simple way to collect premiums from the insured employees.

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Characteristics of Group Insurance

- Premiums are charged from year to year according to the ages in the respective years and will increase for every member as his age goes up and are subject to experience rating. The premium rates change according to the actual mortality experience of the group.
- Group insurance contract is a continuous contract. New persons are added to the group from time to time and exit from employment results in termination of cover. Since it is part of employer's overall employee welfare plan, it is rarely discontinued.

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Eligibility conditions for group Insurance

- **Reason for Group Existence:** The group should be cohesive and formed for mutual continuing interest other than for obtaining insurance.
- **Stability of the Group:** There should be a steady flow of new persons to the group as older persons retire to ensure predicted mortality experience and attain desired profitability and persistency i.e. some new young persons must join the group while aged and impaired individuals leave the group. Otherwise the group will contain proportionate number of aging lives and will result in adverse selection.
- **Determination of Benefits:** Group insurance underwriting rules require that the plan have an automatic basis for determining the amount of benefits applicable to an individual beyond the control of employer or employee. Thus the eligibility norms and benefits must be formulated on the basis of conditions pertaining to employment. For example, the amount of group life insurance is usually related to individual's earnings or job classification.

DIMR

Eligibility conditions for group Insurance

- **High Percentage of Participation in the Group Plan:** In order to get sufficient risk spread, it is necessary that all or substantial percentage of the eligible persons in the group should participate in the group plan. Standard underwriting requirements usually call for at least 75% of those eligible members for the plan, if it is contributory and 100% if it is non-contributory where employer pays full premium of the policy.
- **Significant Sharing of the Cost by the Employer:** This plan encourages participation of eligible employees due to its low cost in relation to the other insurance products and the wide cost fluctuations which are absorbed by adjusting employer's contribution rather than increasing employee's contribution.

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Types of Group Insurance plans

- **Group Life Insurance Plans**
- **Group Medical Insurance Plans And Managed Care**
- **Group Disability Income Plan**
- **Workers' Compensation**

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Group Life Insurance Plans

- Majority of group life plans are term insurance plans and the coverage and premiums are annually renewable. The premium may be adjusted based on the group's mortality experience. Benefits of group term plan are payable only in the event of death of employee during the employment period.

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Types of Group Life Insurance Schemes



Group Savings Linked Insurance Scheme

- This plan benefits of insurance as well as savings to the employees in a single package.
- Under this scheme the members are divided into four subclasses.
- The insurance cover for the members of each group is fixed. The premiums are predetermined by the insurer for every group that will be remitted by the group policyholder.
- The premium is further divided into two parts—death risk premium and savings.
- The risk premium is allocated towards insurance and balance amount is transferred to the individual's account. This contract matures normally on the date of superannuation of the employee.



Types of Group Life Insurance Schemes

Group Gratuity Scheme

- This is to provide lump sum benefit to the group of employees on their retirement from service or leaving the job after attaining specified years of continuous service.
- It is mandatory as per the payment of Gratuity Act for the employers with 10 or more than 10 employees to make payment of gratuity to the employees leaving service after rendering at least 5 years of continuous service.
- This minimum service is not required in case of death or dismemberment.

Types of Group Life Insurance Schemes

The amount of gratuity payable under the act is at the rate of 15 days' wages based on wages last drawn from each year of service subject to maximum gratuity prescribed from time to time (at present maximum limit is Rs. 3,50,000).

DIMR

Types of Group Life Insurance Schemes

- **Group Superannuation Contracts**
- Under this scheme, the employer has to pay a regular superannuation pension to the employees for this purpose.
- For this, the employer sets up an irrevocable trust to which the employer will transfer the funds.
- Under the superannuation contract, the payment of pensions in the event of death of an employee during service is higher as compared to the benefits offered by the trust-managed funds.

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Types of Group Life Insurance Schemes

There are two types of schemes—

- **Cash purchase scheme:** As per the cash purchase scheme, the amount of contributions to the superannuation scheme for each employee is fixed and is expressed as a percentage of the salary.
- **Benefit purchase scheme:** In this the amount of pension payable to the employee or his dependents is predetermined as a percentage of last drawn salary and the amount or money required to be contributed for securing the benefit will be computed by the insurers from time to time and employer will have to make the necessary contributions through the trustees

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Types of Group Life Insurance Schemes

Employees' State Insurance Scheme:

- Employees' State Insurance Scheme of India is an integrated social security scheme tailored to provide social protection to workers and their dependants, in the organised sector, in contingencies, such as, sickness, maternity and death or disablement due to an employment injury or occupational hazard.
- The ESI Scheme is mainly financed by contributions raised from employees covered under the scheme and their employers, as a fixed percentage of wages. Employees of covered units and establishments drawing wages upto Rs.6500/- per month come under the purview of the scheme for social security benefits. However, employees' earning upto Rs.40/- a day as wages are exempted from payment of their part of contribution.

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Types of Group Life Insurance Schemes

- The State Governments bear one-eighth share of expenditure on Medical Benefit within the per capita ceiling of Rs.600/- per annum and all additional expenditure beyond the ceiling.
- Employees covered under the scheme are entitled to medical facilities for self and dependants. They are also entitled to cash benefits in the event of specified contingencies resulting in loss of wages or earning capacity. The insured women are entitled to maternity benefit for confinement. Where death of an insured employee occurs due to employment injury, the dependants are entitled to family pension

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WORKMEN'S COMPENSATION INSURANCE



THE INDIAN WORKMEN'S COMPENSATION ACT, 1923:

- The act provides for the payment of compensation by an Employer to his Employees (for their dependants in the event of fatal accidents), if personal injury is caused to them by accidents arising out of and in the course of their employment.

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WORKMEN'S COMPENSATION INSURANCE



- The maximum compensation payable is upon the following scale (as per W.C. Amendment Act, 2000)
- Fatal Injury -Rs. 4,57,080
- Permanent Total Disablement -Rs. 5,48,496
- Permanent Partial Disablement -According to incapacity caused.
- Temporary Disablement Rs. 2000 pm upto a period of 5 years

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Retirement Planning and Strategies

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Retirement Planning- An overview

- Life Expectancy is increasing, as is the cost of living.
- Market Interest rates are falling and inflation has an erosive effect on the purchasing power of money.
- It is therefore important for you to plan for your retirement.

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Objectives of Retirement Planning

- Maintaining the desired life style
- Financial independence
- Tax savings
- Retire at a particular age

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Estimating Retirement Expenses

- **Find out your current expenditure:** Some expenses will reduce at retirement- your loans may be paid off, work- related expenses will be lower. However, medical expenses, Leisure and entertainment expenses may increase.
- **Predict inflation rate:** Inflation will lead to increased prices, which will lead to increased expenses at the time of retirement.
- **Find out the average rate of return on your investments:** Choose the average rate of return you expect to earn on your investments

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Estimating Retirement Expenses

- Now, project what your expenses will be in retirement.
- First, list how much you now spend.
- Next, figure how much you would spend if you were to retire tomorrow. Would it be more, less, or the same amount that you are now spending?
- Now, using the annual rate of inflation, multiply your estimated retirement expenses by the inflation adjustment factor.
- If you decide to use one rate to adjust all expenses instead of different rates for different expense categories, you can simply multiply the total amount by the inflation adjustment factor.

Sources of retirement income

- Typically, retirement income comes from 3 sources:
- Social Security
- Pensions and savings
- Investments

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Determining the client's retirement income needs

- **Replacement ratio method:**

Most people need between **68 percent** and **90 percent** of their **pre-retirement income** to maintain the same standard of living after retirement. The actual percentage depends upon the income they earned before they retired.

- **Actual Expense Method:**

This method requires the client to make estimates of expected rupee outlays for each expense category.

Retirement Income Streams

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Retirement Income Streams

- In this chapter, we will study various income streams during retirement. It is important to pick the right retirement income stream for you.
- However, when making your decision it's important to consider:
 - Flexibility of income payments;
 - Access to capital;
 - Underlying investment risk; and
 - Is the income stream a complying pension or annuity?

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Types of Income Streams

- Allocated income streams
- There are two types of allocated income streams:
 - Allocated annuity - These are issued through a life insurance company; and
 - Allocated pension - These are issued through a superannuation fund.

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Advantages and Disadvantages of Allocated Income Streams



Advantages	Disadvantages
A relatively flexible income	The payments stop when the funds are exhausted
Access to your capital	Accessing your capital may attract tax
Regular income payment	Need to reset income amounts annually
Numerous investment choices	Investment returns will fluctuate with markets
Part or total withdrawal is possible, however ETP tax is payable	Not complying for either Centrelink or RBL purposes

Types or Income Streams

- Lifetime income streams
- There are two types of lifetime income streams:
- Lifetime annuity – any money can be invested into this income stream. These are issued through a life insurance company; and
- Lifetime pension – only super money can be invested into this income stream. These are issued through a superannuation fund. If you wish to contribute non-super funds to a lifetime pension, you need to first contribute them into a super fund prior to placing them into an income stream.

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Advantages and Disadvantages of Lifetime Income Streams



Advantages	Disadvantages
Guaranteed lifetime income	Inflexible income
Payments will not fluctuate with the markets	Income stream cannot grow from rate or market movements
Is complying for RBL and social security purposes	Cannot access the capital invested
Can be reversionary to spouse (if you die during the payment term, your spouse will receive a percentage of the remaining payments)	There may be a loss of capital if both spouses die prior to the end of the term

Types or Income Streams

- Life expectancy income streams
- There are two types of life expectancy income streams:
- Life expectancy annuity – any money can be invested into an income stream. These are issued through a life insurance company;
- Life expectancy pension – only super funds can be invested into this income stream. These are issued through a superannuation fund. If you wish to contribute non-super funds into a life expectancy pension, you need to first contribute them to a super fund prior to placing them into this income stream.

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Advantages and Disadvantages of Lifetime expectancy Income Streams

Advantages	Disadvantages
Guaranteed income for set period	Inflexible income
Payments will not fluctuate with the markets	Income stream cannot grow from rate or market movements
Once your stream is organised, there is nothing more to do	Cannot access the capital invested
Can index to inflation	If you outlive the income term, you need to rely on other investments for income
Can be complying for Centrelink and RBL purposes	Only complying if purchased after the eligibility age for the Age Pension

Types or Income Streams

- Fixed term income streams
- There are two types of fixed term income streams:
- Fixed term annuity – any money can be invested into this income stream. These are issued through a life insurance company;
- Fixed term pension – only super funds can be invested into this income stream. These are issued through a super fund. If you wish to contribute non-super funds, you need to first contribute them into a super fund prior to placing them into an income stream.

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Advantages and Disadvantages of Fixed Income Streams



Advantages	Disadvantages
Guaranteed income for set period	Inflexible income
Payments will not fluctuate with the markets	Income stream cannot grow from rate or market movements
Can nominate desired residual value	Cannot generally access the capital invested during fixed term
Can be reversionary to spouse (spouse receives remainder of payments upon death of partner)	Not complying for Centrelink or RBL purposes

Pension Sector Reforms

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Existing Pension Systems

- Pension system for Government employees
- Pension system for employees in the organized sector
- Voluntary pension schemes

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Existing Pension Systems

- **Pension system for Government employees**
- Typically unfunded pay-as-you-go defined benefit scheme.
- The Government does not provide for its pension liabilities as they accrue during the working life of its employees but pays its
- The contribution towards the pension scheme is funded solely by the Government and not matched by a contribution from the employees.

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Existing Pension Systems



- **Pension system for employees in the organized sector**
- The Employees Provident Organization ('EPFO') established in 1952, a mandatory program for employees of certain establishments, is a contributory program that provides for periodic contributions of 10 to 12 percent of basic salary by both, the employer and the employees. The contribution is invested in prescribed securities and the accumulated balance in the fund (including the accretion thereto) is paid to the employee as a lump sum on retirement.
- Additionally, in 1995, the Employees Pension Scheme was introduced to replace the erstwhile Family pension programs
- The scheme is a defined benefit programme under which 8.33 percent of the employer's provident fund contribution or Rs 541, whichever is more, is accumulated in a pension fund. The benefits paid out to the employees are a function of the employees' salary on retirement and are not linked to the accumulated contribution pool.

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Existing Pension Systems

- Voluntary pension scheme
- These are pension schemes administered by the Government (e.g. the Public Provident Fund to which contribution may be made upto a maximum of Rs 70,000 per annum) or insurance companies, where the contribution may be made on a voluntary basis.
- Such voluntary contributions are often driven by tax benefits offered under the scheme.
- Persons covered under organized pension plans as well as the population in the unorganized sector may contribute to voluntary pensions schemes.

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Existing Pension Systems

- Other plans:
- Besides the above, there are certain other social security nets aimed at poverty alleviation in respect of the unorganized sector. While India does not boast of a wide social security net, the Central Government and certain state Governments have in place schemes to cater to the poorest elderly.

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Need for Pension Reforms

- The current one caters to only a small portion of the workforce and is financially unsustainable.
- While India makes up about 16.3 per cent of the world population, its elderly population is only about 12.5 per cent of the world's elderly population. India's population is currently relatively young but this will change as health and other social initiatives lead to continuous improvement in birth and death rates.
- There are currently 70 million people over the age of 60 in India and fewer than 10 per cent of them have their pension; the others have to work or rely on transfers, mainly from their children.

Need for Pension Reforms

- A recent survey commissioned by the Pension Fund Regulatory and Development Authority and Asian Development Bank revealed that post-retirement dependence on children is 71 per cent in rural areas and 59 per cent in urban areas.
- The Old Age Social and Income Security Committee, constituted to examine policy questions connected with old-age income security, enunciated the basic philosophy of pension reforms, namely that "economic security during old age should necessarily result from sustained preparation through life-long contributions" and that "the government should step in only in case of those who do not have sufficient incomes to save for old age".

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Need for Pension Reforms

- In its second report, the OASIS recommended the introduction of defined contribution, fully funded, individual retirement account pensions, with the fund management of these entrusted to private fund managers.
- The aim of any pension reform initiative is to reduce the unfunded pension liability, reduce the role of the state as pension provider and increase the pension coverage.

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Inefficiencies of the traditional pension system

- The EPFO has registered an average real rate of return of only about 2.5 percent between 1990 to 2000; this is largely influenced by the several investment restrictions that encourage Government consumption of pension funds rather than allocating pension funds optimally to other long-term avenues.
- The total contribution of about 24 percent of basic pay (12 percent each by the employer and employee) is one of the highest contribution rates in the world. This high contribution rate leaves the employees with little disposable surplus for other consumption and prompts premature withdrawals from the pension funds; the mean account balance of an employee covered in the EPFO on retirement is about Rs. 20,000.

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Inefficiencies of the traditional pension system

- The Government's unfunded pension liability is burgeoning and its sustainability on a defined benefit pay-as-you-go basis could require heavy deficit financing in future. This has not been helped by the generous increments suggested by the Pay Commissions over the years.
- What seems like an elaborate network of organised pension schemes covers only 11 percent of India's working population.
- The current pension schemes are based on a defined benefit mechanism that exposes pensioners to inflation risk.
- The current pension schemes leave a lot to be desired in terms of service delivery mechanism and customer convenience.

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The reform process

- The Government commissioned a national project titled OASIS and nominated an 8 member expert committee chaired by Mr. SA Dave to suggest policy changes to the existing pension framework.
- The Committee presented its report in January 2000 recommending a system for private-sector management of pension funds to generate market-linked returns with, inter-alia, the following features.

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The reform process

- The pension system would be based on individual retirement accounts with full portability across geographical locations and job changes would be accessible on a nationwide basis through 'points of presence' such as post-offices, bank branches, depository participants, etc and contributions to the pension account would be flexible; though pre-mature withdrawals will not be permissible; micro-credit facility would be available against the pension account.
- Six pension fund managers would be appointed to manage the pension funds based on the lowest fee bids.

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The reform process

- Each pension manager would offer three schemes, viz. safe income, balanced income and growth plans of which the pension account holder could select any one; further the pension account holder would be free to switch between pension schemes.
- Records of the pension accounts would be centralised with a central depository to minimise overheads.
- A separate Pensions Regulatory Authority would be set-up to regulate the pension system.
- Funds accumulated by the pension provider would be handed over to an annuity provider on the pension account holder attaining retirement age.

The challenges ahead and way forward

- Also, though the Government has indicated that foreign direct investment would be permissible in the pension sector, a policy announcement to this effect and the percentage of foreign direct investment that would be permissible is yet to be announced.
- We can expect tie-ups with Indian Banks with strong brand and reach
- The policy for taxing pension products may also need revisiting given that contribution to voluntary pension schemes are largely driven by the tax benefits available in respect of the contributions.

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Conclusion

- Pension reforms in other countries reveal that it is a long drawn process that requires consistent commitment from the Government.
- For a country of India's size and population, flexibility in pension opportunities will play a significant role in its success.
- While it is necessary that rules and regulations be laid down to regulate the pension system, the number and stringency of these rules should keep in mind the overall objective of the pension system.
- With the formulation of the new pension scheme, the Government's job has just begun; the bigger objective is to change the ideology of India's population and to engrave in them the importance of saving the best for the last.

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Thank You!

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