M.COM SEMESTER - IV, (C. NO. M.COM-FE454)

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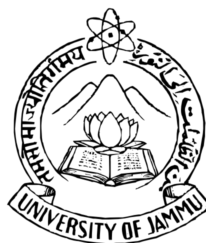

SELF LEARNING MATERIAL

FOR

M.COM. FOURTH SEMESTER

FINANCIAL PLANNING

Session 2024-2025

COURSE NO: M.COM-FE454	FINANCIAL PLANNING	UNIT : I-IV

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DIRECTORATE OF DISTANCE & ONLINE EDUCATION
UNIVERSITY OF JAMMU
SYLLABUS
M.COM. FOURTH SEMESTER (NON CBCS)
FINANCIAL PLANNING
(Core Course)

Course: M.COM-FE454	**Max Marks: 100 Marks**
Credit: 4	**External: 80 Marks**
Time: 3.00 Hrs	**Internal: 20 Marks**

(Syllabus for the examination to be held in May 2024, 2025, 2026)

COURSE OBJECTIVES

1. To provide understanding to the students about need of financial planning.
2. To acquaint the students with risk analysis and insurance planning.
3. To impart knowledge about various retirement plans and employee benefits.
4. To familiarize students with tax, estate and advance financial planning.

COURSE OUTCOMES

After the completion of this course students will be able to:

1. understand the basic premise of financial planning,
2. analyse risk and devise appropriate insurance plans,
3. learn about retirement planning and employee benefits;
4. understand taxation principles related to financial planning;
5. describe ethical & business aspects of financial planning.

UNIT - I INTRODUCTION TO FINANCIAL PLANNING

Concept; Financial Planning Process; Client interactions; Time value of money applications; Cash flow and debt management; Asset acquisition; Education

planning; Overview of risk management; Investment planning; Retirement planning; Special circumstances; Ethics and business aspects of financial planning

UNIT II RISK ANALYSIS AND INSURANCE PLANNING

Risk management and insurance decisions in personal financial planning; Identifying client's exposure to mortality, health, disability, property, liability and long term care risk; Selecting the appropriate risk management technique; Insurance pricing; Insurance policies and Strategies: General insurance, life insurance, motor insurance, medical insurance, insurance of business risk and regulation of insurance industry.

UNIT - III RETIREMENT PLANNING AND EMPLOYEE BENEFITS

Concept; retirement need analysis techniques; Process of retirement planning; Development of retirement plans; Retirement schemes: Employee provident fund, public provident fund, superannuation fund, gratuity; Retirement products available in the market; Pension reforms in India; OECD guidelines for Pension fund governance; Regulatory framework of Retirement Plans: Regulation of pension sector, pension plans, annuities of life insurance companies and mutual funds, superannuation funds.

UNIT IV TAX, ESTATE AND ADVANCE FINANCIAL PLANNING

Principles of taxation; Taxable income; other principles of taxation; Taxation of direct investments; Taxation of pooled investments; Self assessment and Payment of Income tax; Capital gains tax; Tax Avoidance vs Tax Evasion; Estate Planning: Will; Other modes of estate transfer; Administration of an estate; Other methods of Passing Assets; Power of Attorney, Tax Planning through Wills and trusts; Advance financial Planning: Establishing client partner relationships; Analyse client objectives, need and financial situation; Developing, implementing and monitoring financial plan.

SUGGESTIVE READINGS

1. Sinha, M. Financial Planning- A Ready Reckoner. Tata McGraw-Hill, New Delhi.

2. Singhania, V.K. & K. Singhania, Direct Taxes Law and Practice. Taxmann, New Delhi.
3. Bodie, Z., A. Kane, A.J. Marcus & P. Mohanty. Investments. McGraw-Hill, New Delhi.
4. Indian Institute of Banking and Finance, Introduction to Financial Planning. Taxmann, New Delhi.
5. Indian Institute of Banking and Finance, Risk Analysis, Insurance and Retirement Planning. Taxmann, New Delhi.
6. Indian Institute of Banking and Finance, Investment Planning, Tax Planning and Estate Planning.Taxmann, New Delhi.

Note: Latest edition of the books may be preferred.

NOTE FOR PAPER SETTING

The paper consists of two sections. Each section will cover the whole of the syllabus without repeating the question in the entire paper.

Section A: Section A: It will consist of eight short answer questions, selecting two from each unit. A candidate has to attempt any six and answer to each question shall be within 200 words. Each question carries four marks and total weightage to this section shall be 24 marks.

Section B: It will consist of six essay type questions with answer to each question within 800 words. One question will be set atleast from each unit and the candidate has to attempt four. Each question will carry 14 marks and total weightage shall be 56 marks

MODEL QUESTION PAPER

FINANCIAL PLANNING

Time : 3 hrs **Max Marks : 80**

SECTION - A

Note:- Attempt any six questions. Each question carries 4 marks. Answer to each question should be within 200 words.

1. What is financial planning and why is it important ?
2. Define cash flow, debt management and time value of money.
3. Explain the insurance policy contract and its elements.
4. What do you understand by motor insurance ? Explain its benefits.
5. What are the key features of EPF Scheme ?
6. Discuss the benefits and eligibility criteria for payment of gratuity.
7. What is the difference between direct and indirect tax.
8. What are the primary goals of advanced financial planning ?

SECTION - B

Note:- Attempt any four questions. Each question carries 14 marks. Answer to each question should be within 800 words.

1. Discuss in detail the objectives and process of financial planning.
2. What are the different risk management approaches and methods ? What are the factors to consider while selecting the appropriate risk management technique ?
3. Discuss the concept and techniques of retirement need analysis. Also explain the process of retirement planning.
4. Discuss in detail the benefit of superannuation fund. Also explain its tax treatment and intemation of superannuation fund.
5. Who are the parties involved in estate planning ? Explain the concept of will and other modes of estate transfer ?
6. Discuss the benefit and eligibility criteria for payment of gratuity. Also explain the OECD guidelines for pension fund regulation.

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UNIT-I **LESSON NO. 1**

FINANCIAL PLANNING

INTRODUCTION TO FINANCIAL PLANNING

STRUCTURE

1.1 Introduction

1.2 Objectives

1.3 Concept of Financial Planning

1.4 Definitions of Financial Planning

1.5 Objectives of Financial Planning

1.6 Importance of Financial Planning

1.7 Characteristics of sound Financial Plan

1.8 Different Types of Financial Planning

1.9 Financial Planning Process

1.10 Summary

1.11 Glossary

1.12 Self-Assessment Questions

1.13 Suggested Readings

1.1 INTRODUCTION

A financial plan is a document containing a person's current money situation and long-term monetary goals, as well as strategies to achieve those

goals. A financial plan begins with a thorough evaluation of the person's current financial state and future expectations and may be created independently or with the help of a certified financial planner. One can't create a financial plan without knowing where one's money is going and when. Documenting transactions is the flow of cash in and out that help in determine how much money is needed every month for necessities, how much might be left for saving and investing, and even where one can cut back a little or a lot. A financial plan is a comprehensive evaluation of an individual's current pay and future financial state by using current known variables to predict future income, asset value and withdrawal plans. This often includes a budget which organizes an individual's finances and sometimes includes a series of steps or specific goals for spending and saving in the future. This plan allocates future income to various types of expenses, such as rent or utilities, and also reserves some income for short-term and long- term savings. A financial plan is sometimes referred to as an investment plan, but in personal finance, a financial plan can focus on other specific areas such as risk management, estates, college, or retirement.

Benefits of a Financial Plan

- A financial plan involves a thorough examination of your income and spending.
- It can improve the understanding of your financial circumstances at all times.
- It establishes important short- and long-term financial goals.
- It clarifies the actions required of you to achieve your various financial goals.
- A financial plan can focus your attention on important immediate steps, such as reducing debt and building your savings for emergencies.
- It enhances the probability that you'll achieve financial milestones and overall financial success.

- It can guide your efforts over time and provide a means to monitor your progress.
- It can keep you out of financial trouble and reduce the stress and worry you may have experienced in the past.

1.2 OBJECTIVES

After reading this lesson, you will be able to understand:

- Concept of Financial Planning
- Importance of Financial Planning
- Objectives of Financial Planning
- Different types of Financial Planning
- Financial Planning Process

1.3 CONCEPT OF FINANCIAL PLANNING

Financial planning is the practice of putting together a plan for your future, specifically around how you will manage your finances and prepare for all of the potential costs and issues that may arise. The process involves evaluating your current financial situation, identifying your goals and then developing and implementing relevant recommendations. It is holistic and broad, and it can encompass a variety of services. Rather than focusing on a single aspect of your finances, it views clients as real people with a variety of goals and responsibilities. It then addresses a number of financial realities to figure out how to best enable people to make the most of their lives.

Financial planning is not the same as asset management. Asset management generally refers to managing investments for a client. This includes choosing the stocks, bonds, mutual funds and other investments in which a client should invest their money and also a step-by-step approach to meet one's life goals. A financial plan acts as a guide as you go through life's journey. Essentially, it helps you be in control of your income, expenses and investments such that you can manage your money and achieve your goals. It involves

looking at a client's entire financial picture and advising them on how to achieve their short- and long-term financial goals. From saving for education and planning for retirement to effectively managing taxes and insurance, financial planners develop valuable relationships with their clients to provide them with confidence today and a more secure tomorrow. It is the process of estimating the capital required and determining its competition. It includes framing financial policies in relation to procurement, investment and administration of funds of an enterprise. It helps in determining how a business will afford to achieve its strategic goals and objectives. Usually, a company creates a financial plan immediately after the vision and objectives have been set. The financial plan describes each of the activities, resources, equipment and materials that are needed to achieve these objectives, as well as the timeframes involved.

The Financial Planning activity involves the following tasks:

i. Assess the business environment

ii. Confirm the business vision and objectives

iii. Identify the types of resources needed to achieve these objectives iv.Quantify the amount of resource i.e., labour, equipment, materials. v.Calculate the total cost of each type of resource

vi. Summarize the costs to create a budget vii.Identify any risks and issues with the budget set.

1.4 DEFINITIONS OF FINANCIAL PLANNING

In simple words Financial Planning can be defined as "the process of estimating the capital required and determining it's composition. It is the process of framing financial policies in relation to procurement, investment and administration of funds of an enterprise."

Walker, E.W. and Baughn, W.H. states that "Financial Planning pertains only to the function of finance and includes the determination of the firm's financial objectives, financial policies and financial procedures."

According to **R.M. Shrivastava** "Financial Plan is the act of deciding in advance the quantum of capital requirement and its forms."

In the opinion of **Cohen and Robbins** "Financial planning should determine the financial resources required to meet the company's operating programme. Forecast the extent to which these requirements will be met by internal generation of funds and the extent to which they will be met from external sources. Develop the best plans to obtain the required external funds. Establish and maintain a system of financial control governing the allocation and use of funds. Formulate programmes to provide the most effective profit-volume-cost relationship. Analyze the financial results of operations, report facts to the top management and make recommendations on future operations of the firm."

1.5 OBJECTIVES OF FINANCIAL PLANNING

Financial planning anticipates future cash requirements and ensures smooth cash flow at all times and allows you to control your financial matters by avoiding excessive debt and dependence on others. It improves personal relationships as all financial decisions become well planned and are communicated to others effectively. The objectives of a sound financial plan are to make you cash ready by creating reserves to meet the following needs: -

1. **Medical Emergencies:** Medical expenses are an area where the cash flows out unexpectedly. Therefore, the first part of your financial plan should be focused on protecting yourself and your family through a good medical claim policy. Doing so will also take care of any unexpected expenses related to medical emergencies. Besides protection from medical expenses, you can also avail of tax benefits under the Income Tax Act.

2. **Insurance:** The term insurance component of financial planning offers you the much- needed protection for uncertainties. Term policies require low premiums and provide maximum protection, making them cost-efficient. It also provides you tax exemptions under India's Income Tax

Act. Further, you can apply for policies to protect major assets such as your home and vehicle from theft, fire or other unforeseen incidents.

3. **Children's future:** One of the prime objectives of a financial plan is to keep us prepared for our children's expenses, like their education and wedding. Mutual fund investments can help secure our children's future. Investment in equity mutual funds or children's fund can help build a corpus of wealth until they turn into young adults.

4. **Retirement:** Proper financial planning will help you plan better for your retirement period right from the beginning of your career. You can choose investment instruments such as mutual funds, bank fixed deposits or invest in the stock market through expert advice. This will help in timely creating a retirement fund so that you lead a happy and relaxed retired life

5. **Determining capital requirements:** Capital requirements have to be looked with both aspects: short- term and long- term requirements. This will depend upon factors like cost of current and fixed assets, promotional expenses and long- range planning.

1.6 IMPORTANCE OF FINANCIAL PLANNING

Financial planning plays an important role in giving direction to your goals. It helps you to set short-term and long-term goals in life and helps you make financial decisions more easily. It instils discipline in terms of managing and handling your money. One can cut on unnecessary expenses and start saving with the help of financial planning. Following are certain points that will help you understand the importance of financial planning:

1. **Helps in managing income:** A good financial plan helps you to manage your income better. As we all know that everyone need money for their basic needs but occasionally tend to splurge on unnecessary luxuries. Planning your finances will keep a check on your expenses and help you make savings. As you will have a budget ready, you can easily assess whether you are overspending or are within budget. This will

help you understand how much you need to save and to reach your goals and also helps in ensuring a reasonable balance between outflow and inflow of funds so that stability is maintained.

2. **Help choose investments:** It is essential to have a financial plan for choosing investments in line with your income, risk capacity and goals. Financial Planning ensures that the suppliers of funds are easily investing in companies which exercise financial planning. This will help you maintain a balanced investment portfolio at all times. A sound financial plan will also help you assess your tax obligations at the beginning of a financial year. So you can plan your finances accordingly in such a manner that you pay the least amount as tax legally.

3. **Manage inflation:** Financial planning helps you to manage inflation by planning your budget in a better way. This eventually gives you peace of mind because then only you will be able to get a clear picture of your future finances. You will be aware of when your investments will give returns and how and when you will achieve your goals. It reduces uncertainties with regards to changing market trends which can be faced easily through enough funds.

4. **Takes care of the estate:** A financial plan will guide those taking care of your finances to manage your estate efficiently. Financial planning includes estate planning, which means the smooth distribution of your wealth after your death. In essence, a proper financial plan makes things smoother. Life is unpredictable, any incident can happen at any moment and you may need money urgently.

5. **Retirement lifestyle:** Relaxed retirement life is possible only if your finances are in a healthy state and are in order. This means having enough cash reserves for medical expenses and other emergencies. A proper financial plan will have your retirement goals listed, including your income and expenses as detailed as possible. Financial planning helps in making growth and expansion programmes which help in long-run survival.

1.7 CHARACTERISTICS OF A SOUND FINANCIAL PLAN

While preparing a financial plan for any business unit, the following aspects should be kept in view so as to ensure the success of such exercise in meeting the organisational objectives.

(a) **The plan must be simple:** Now-a-days you have a large variety of securities that can be issued to raise capital from the market. But it is considered better to confine to equity shares and simple fixed interest bearing debentures.

(b) **It must take a long term view:** While estimating the capital needs of a firm and raising the required funds, a long-term view is necessary. It ensures that the plan fully provides for meeting the capital requirement on long term basis and takes care of the changes in capital requirement from year to year.

(c) **It must be flexible:** While the financial plan is based on long term view, one may not be able to properly visualise the possible developments in future. Not only that, the firm may also change its plans of expansion for various reasons. Hence, it is very necessary that the financial plan is capable of being adjusted and revised without any difficulty and delay so as to meet the requirements of the changed circumstances.

(d) **It must ensure optimal use of funds:** The plan should provide for raising reasonable amount of funds. As stated earlier, the business should neither be starved of funds nor have surplus funds. It must be strictly need based and every rupee raised should be effectively utilised. There should be no idle funds.

(e) **The cost of funds raised should be fully taken into account and kept at the lowest possible level:** It must be ensured that the cost of funds raised is reasonable. The plan should provide for a financial mix (combination of debt and equity) that is most economical in terms of cost of capital, otherwise it will adversely affect the return on shareholders' funds.

(f) **Adequate liquidity must be ensured:** Liquidity refers to the ability of a firm to make available the necessary amount of cash as and when required. It has to be ensured in order to avoid any embarrassment to the management and the loss of goodwill among the investors. In other words, the investment of funds should be so planned that some of these can be converted into cash to meet all possible eventualities.

1.8 DIFFERENT TYPES OF FINANCIAL PLANNING

A financial planner may offer a variety of services to you. These services will often be considered in concert with one another. This helps the planner put together an overall plan that considers all aspects of your current situation and future aspirations. Here are eight common services that are generally offered as part of financial planning:

- **Tax planning:** Financial planners often help clients address certain tax issues. They can also figure out how to maximize your tax refunds and minimize your tax liability. Certain advisors may also be able to actually help you with preparing your taxes and filing your annual taxes.
- **Estate planning:** Estate planning seeks to make things a bit easier for your loved ones after you die. Preparing a will may be part of a financial planner's services. Estate planning also helps prepare for any estate tax you may be subject to.
- **Retirement planning:** You presumably want to stop working someday. Retirement planning services help you prepare for that day. They ensure that you've saved enough money to live the lifestyle you want in retirement.
- **Philanthropic planning:** It's always nice to give something to people who need it or help a cause close to your heart. Financial planning can help you ensure you're doing it efficiently and getting all the tax benefits you're eligible for.
- **Education funding planning:** If you have children or other dependents

who wish to pursue a college degree, you may want to help them to pay for it. Financial planning can help make sure you are able to do so.

- **Investment planning:** Though financial planning doesn't have to include the actual management of your assets – but most often does – it can still help with your investment portfolio by mapping out how much you should be investing and in which types of investments.
- **Insurance planning:** A financial planner can help you evaluate your insurance needs. Some financial planners are also licensed insurance agents and can sell you insurance themselves. However, they'll likely earn a commission, which would create a conflict of interest.
- **Budgeting:** This is perhaps the cornerstone of financial planning. A planner can make sure you are spending the right amount given your income and can also make sure that you aren't going into debt.

1.9 FINANCIAL PLANNING PROCESS

Financial Planning Process is a collaborative, iterative approach that financial planning professionals use to consider all aspects of a client's financial situation when formulating financial planning strategies and making recommendations. It involves evaluating an individual's or family's current financial situation, identifying financial goals, creating a plan to achieve those goals, implementing the plan, and regularly monitoring and adjusting the plan as needed. Financial planning is creating a vision for your financial future and following through on it. So the process of financial planning helps in evaluating your net worth and risk profile, setting short to long-term financial goals, and revising your goals over time, if necessary. The process is arranged into six elements:

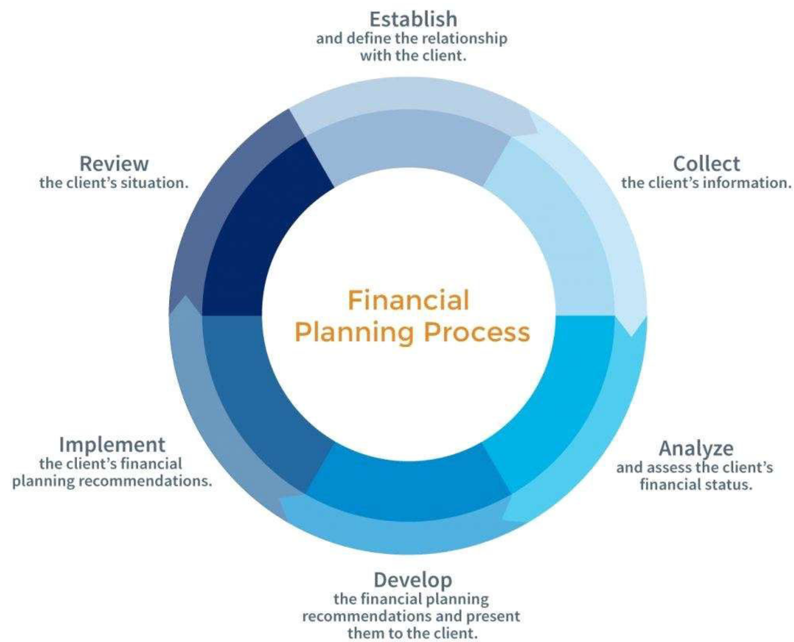

Figure 1 Financial Planning Process

1. **Establish and define the relationship with the client:** The financial planning professional informs the client about the financial planning process, the services the financial planning professional offers, and the financial planning professional's competencies and experience. The financial planning professional and the client determine whether the services offered by the financial planning professional and his or her competencies meet the needs of the client. The financial planning professional considers his or her skills, knowledge and experience in providing the services requested or likely to be required by the client. The financial planning professional determines if he or she has, and discloses, any conflict(s) of interest. The financial planning professional and the client agree on the services to be provided. The financial planning professional describes, in writing, the scope of the engagement before any financial planning is provided, including details about: the

responsibilities of each party (including third parties); the terms of the engagement; and compensation and conflict(s) of interest of the financial planning professional. The scope of the engagement is set out in writing in a formal document signed by both parties or formally accepted by the client and includes a process for terminating the engagement.

2. **Collect the client's information:** The financial planning professional and the client identify the client's personal and financial objectives, needs and priorities that are relevant to the scope of the engagement before making and/or implementing any recommendations. The financial planning professional collects sufficient quantitative and qualitative information and documents about the client relevant to the scope of the engagement before making and/or implementing any recommendations.

3. **Analyze and assess the client's financial status:**The financial planning professional analyzes the client's information, subject to the scope of the engagement, to gain an understanding of the client's financial situation. The financial planning professional assesses the strengths and weaknesses of the client's current financial situation and compares them to the client's objectives, needs and priorities.

4. **Develop the financial planning recommendations and present them to the client:** The financial planning professional considers one or more strategies relevant to the client's current situation that could reasonably meet the client's objectives, needs and priorities; develops the financial planning recommendations based on the selected strategies to reasonably meet the client's confirmed objectives, needs and priorities; and presents the financial planning recommendations and the supporting rationale in a way that allows the client to make an informed decision.

5. **Implement the financial planning recommendations:** The financial planning professional and the client agree on implementation responsibilities that are consistent with the scope of the engagement, the client's acceptance of the financial planning recommendations, and the financial planning professional's ability to implement the financial

planning recommendations. Based on the scope of the engagement, the financial planning professional identifies and presents appropriate product(s) and service(s) that are consistent with the financial planning recommendations accepted by the client.

6. **Review the client's situation:** The financial planning professional and client mutually define and agree on terms for reviewing and revaluating the client's situation, including goals, risk profile, lifestyle and other relevant changes. If conducting a review, the financial planning professional and the client review the client's situation to assess progress toward achievement of the objectives of the financial planning recommendations, determine if the recommendations are still appropriate and confirm any revisions mutually considered necessary.

1.10 SUMMARY

In this lesson one can able to understand that financial planning is a process of determining a way to achieve financial goals that helps us to find the way to achieve that goals in life. It acts as a guide for decision making. One can decide on where to invest and when using a financial plan. It also helps set standards and helps in continuous monitoring of the performance of investments with the goals. Financial planning helps not only secure the financial future but also reduces mental and emotional stress. It also acts as a great source of motivation. It requires real work for anyone to live on their own terms even after retirement. This goes to show the importance of financial planning and should nudge you to go for sound financial planning for your future years. It is a catalyst that propels an organization while safeguarding them from failure during uncertain times. Whether you are a start-up with a bold vision or a well-established enterprise seeking to maintain its competitive edge, effective financial planning is critical to financial management. Financial planning serves as the compass that guides strategic decisions and resource allocation and ultimately shapes the destiny of a business. It is more than just crunching numbers and forecasting revenue. It is a strategic endeavour that requires astute foresight, critical analysis, and a deep understanding of the organization's goals

and aspirations. The financial planning process is essential for achieving financial goals and maintaining overall financial well-being. By establishing goals, gathering and analyzing financial data, developing a plan, implementing it, and regularly monitoring and adjusting the plan, individuals can take control of their personal finances. Seeking the advice of financial professionals and avoiding common mistakes can further enhance the effectiveness of the financial planning process.

1.11 GLOSSARY

- Vision: A long term perspective of what is the final destination of the organisation.
- Financial Plan: A financial plan documents an individual's shortand long-term financial goals and includes a strategy to achieve them.
- Capital Structure: The capital structure is the composition of capital, i.e., the relative kind and proportion of capital required in the business.
- Retirement: Retirement refers to the time of life when one chooses to permanently leave the workforce behind.

1.12 SELF-ASSESSMENT QUESTIONS

Q1. Define the term Financial Planning.

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Q2. Write down the importance of Financial Planning.

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Q3. Discuss the Financial planning Process.

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1.13 SUGGESTED READINGS

- Financial Planning by Anjana Dhand
- Financial plans: Meaning, Purpose and Key Components by Liz Manning
- Financial Planning by Dr.KasamsettySailatha
- Financial Planning Process by FPSB
- What Is Financial Planning? Definition, Meaning and Purpose by Ben Geier

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UNIT-I LESSON NO. 2

FINANCIAL PLANNING

CLIENT INTERACTION AND TIME VALUE OF MONEY

STRUCTURE

2.1 Introduction

2.2 Objectives

2.3 Meaning of Client Interaction

2.4 Importance of Client Interaction

2.5 Ten Ways to Make Every Customer Interaction Positive

2.6 Concept of Time Value of Money

2.7 Significance of Time Value of Money

2.8 Applications of TVM

2.9 Summary

2.10 Glossary

2.11 Self-Assessment Questions

2.12 Suggested Readings

2.1 INTRODUCTION

If we talk about interaction we can say that, for every interaction, there is an equal and opposite reaction. Customer satisfaction is at the heart of every business strategy, and it all starts with how you handle your communication

with your customers. Clients today have purchasing power like never before, which is why good client interaction skills can make or break a brand. It's no longer just about how much a customer can buy; their power lies more in having control over what, where, why, and how they shop. What's even more significant is that consumers now also have the power to influence other (potential) consumers, becoming critics and sharing their opinions all over the online landscape. A customer may purchase one electric toothbrush over another simply because they can have it delivered to their home the next day. They may choose one web hosting company over another because of their customer support reputation. They may schedule an appointment with a particular dentist because he or she offers a great loyalty program and on and on. Customer interactions can quite literally make or break your reputation and conversion rates. Paying attention to every interaction can help you understand what customers want and how you can serve them better. Talking to your customers doesn't have to be drawn out and complicated. Leveraging customer communications management software can simplify the process by storing and analyzing customer information from the get-go. Effective customer conversations help meet customer expectations while building trust and loyalty toward your brand and products. While there are several ways to improve your customer interaction practices, it's important to remember that communication is an ongoing process and requires consistent time and effort. Interaction with the client is a relationship with the client, which aims to satisfy their needs and meet their expectations. However, it should not only end there, rather should also be carried out in a way that will build a long-term relationship with the client. Effectively managing client interactions is crucial for building strong relationships and increasing customer satisfaction. Utilizing advanced software and training sales teams can aid in collecting data and improving customer experiences. Live agent offers help desk software and automation rules to assist with automatic ticket distribution. With an overwhelming amount of options, price is no longer the main defining factor for purchasing a product or service. Understanding the best practices for how to interact with customers also comes into play.

2.2 OBJECTIVES

After reading this lesson, you will be able to understand:

- Concept of Client Interaction
- Importance of Client Interaction
- Concept of time value of money (TVM)
- Various applications of TVM

2.3 MEANING OF CLIENT INTERACTION

Client interaction or Customer interaction refers to any communication between a business and its customers. These interactions can occur over multiple channels such as phone calls, text messages, social media, self-service portals, and chat boot services. Customers can interact with businesses for queries, feedback, or general customer service requests. It play an integral role in every step of the customers journey from the first impression during customer on boarding to requesting feedback and maintaining customer loyalty. There may be as many examples of interaction with clients as there are clients and their individual cases. General examples are: phone call, reply to comments on social media, contact by email. As a result of these interactions, it is possible to build an emotional relationship with the client, use feedback from clients and focus primarily on the client's needs. Other interesting examples are the use of artificial intelligence that can support action. It is also extremely important to use honest human language. As **Marcus** says, "If you have good relationship with clients, people for the most part will stop shopping on pennies". Thanks to a highly competitive market no longer dominated by big brands, businesses in the 21st century have to surpass expectations on every level. That's why good customer interaction skills are a must for any employee. From quality, value, price, corporate culture and social responsibility, to customer support and governance practices and more— good customer interaction at every touch point is the key. In fact, according to the Harvard Business Review, Fortune Global 500 firms spend around $20 billion a year on corporate social responsibility activities.

Five Stages of a Client Interaction Cycle

Successful businesses have a strong understanding of the different stages in the customer interaction process. Here are the five main steps to consider when helping a customer make a buying decision stored and used for a better customer experience.

1. **Awareness:** Customers at this stage are very early in their purchase journey and are simply looking for more information on what your business does and how it can solve their problems.
2. **Consideration:** The consideration stage of the customer interaction cycle helps customers find unique value propositions in your products and evaluate overall suitability for their needs.
3. **Conversion:** Everyone's favourite - it is the stage where you can look forward to new customer acquisition, as the buyer is in the final stage of the sales cycle.
4. **Retention:** Gaining customers should never be the sole goal of your customer service activities. Make sure your customers are satisfied by checking in and asking for consistent feedback.
5. **Advocacy:** Once you're certain of the customers who will remain loyal to you, encourage them to become brand advocates by bringing in new customers in the form of referrals or social shares.

2.4 IMPORTANCE OF CLIENT INTERACTION

Imagine if every difference with your friend could potentially end your friendship; very unfortunate, right? That's precisely how customer interactions work, except that your business could suffer big-time if conversations go wrong. There are certain reasons why customer interaction is important to your business that are given below:

1. **Help understand customer behaviour:** Powerful customer interaction management is the foundation of any successful business. When you interact with a customer, you enable them to voice their concerns, provide

feedback and give insights on what you can do to improve their experience. Positive customer interactions help to analyze what is and isn't working well for your primary stakeholders. This leads to understanding their pain points and purchasing habits, giving you real-time data on what can be done better.

2. **Reduce customer churn rates:** No one likes losing customers. When customers feel heard and believe you care, they're more likely to speak their minds about their experiences. This helps businesses re-evaluate their customer satisfaction activities and review the existing strategies. Honest and transparent customer communication paves the way for low customer attrition rates and improves retention.

3. **Refine business operations:** Customer communication is a great way to get insights into your customers' likes and dislikes. Every interaction offers a different perspective and is a learning opportunity to optimize your product and customer service. When a business pays attention to the customer's voice, it indirectly improves its current operations through regular feedback.

4. **Increase referrals:** Putting effort into creating a positive customer interaction also reduces the chances of negative word-of-mouth reviews. This improves your brand image and enhances the probability of getting referrals from existing customers. Recommendations help grow the customer base organically and are impactful in acquiring new customers. It's simple; if someone likes your product, they'll recommend someone else to try it. Easy wins.

5. **Improve brand reputation and loyalty:** Reputation management can take years to get right. But managing interactions can make it easier to turn new and existing customers into advocates for your brand. This can be achieved by consistently providing a positive customer experience and responding to grievances across channels. Loyal customers are often the ones who drive a business forward and repeatedly buy from you. Establishing strong relationships with customers who believe in your

vision has a substantial impact on your bottom line. Effective customer service interactions can also help win back lost customers, showing that you care about them and want to maintain a good customer relationship.

2.5 TEN WAYS TO MAKE EVERY CUSTOMER INTERACTION POSITIVE

1. **Be Transparent:** Countless businesses highlight transparency as one of their core values but being transparent is more than just a buzzword. It's about good customer interaction skills like always being upfront with customers and not hiding anything. Transparency is taking responsibility for a mistake and explaining how you're going to fix it.

   It means leaving up bad reviews on your website and investigating further what went wrong. May be there's a way to make it up to customers. Being transparent really goes a long way, differentiating your business and making sure no one feels taken advantage of, for long-term good customer interaction.

2. **Interact And Communicate:** When asked how to interact with customers, Fortune 500 company executives list a number of ways to do so, each with their own benefits that even crossover to internal insights such as revamping a marketing or sales strategy. Communicating with a customer in this digital era comes in all shapes and forms. When thinking about how to interact with customers, it's important to note that communication with customers includes before, during, and after your sale. Following-up, checking-in, asking for feedback through a survey, asking for a referral, posting educational blogs, offering a coupon, and sending a note are all ways to communicate post sale. According to Entrepreuneur.com repeat customers spend 67% more (on average) than new customers. Good customer interaction skills really make a difference.

3. **Show Customer Appreciation:** Everyone likes to feel appreciated and

same in case of consumers also; they also want appreciation. As Marcus likes to say, "There is no being generous to a fault because there is no fault in being generous." Consumers have plenty of choices, and as they get more empowered and connected, their decision-making becomes more complex. Showing a token of appreciation to your customers can go a long way to differentiate your company from the next one. There are various ways to show your customers you truly appreciate them for choosing your brand, product or service. And saying thank you is a substantial part of good customer interaction. A skincare company can add a face cream sample to a customer's order. An insurance company can send a card on a customer's birthday. An online vehicle registration company can add a yearly service reminder to a customer's profile. From free upgrades and coupons to thank you notes and early access to sales, even a simple handshake, are all ways to make your customers feel they are getting VIP treatment. You can truly inspire more loyalty and get repeat business by just showing a little bit of gratitude. Remember, good customer interaction skills need practice.

4. **Resolve Problems Quickly:** Interacting with customers successfully means solving the problem quickly, the more you grow as a company, the more exposure you'll have, making your brand more vulnerable. Good customer service goes beyond fixing problems, though it's about anticipating them and having solutions that can turn bad customer experiences around fast. For the CEO of a Seattle-based call analytics public company, resolving problems is top of mind and all about good customer interaction. In a Forbes article, he shares his advice for turning mistakes into opportunities saying, "Ask for feedback from your team, your boss, your clients, anyone. Every bit of feedback, good or bad, pushes us to ask how can we do better? And at the end of the day, this question is what will breed growth and lessons learned from our mistakes or failures. Always ask how you can do better and you will always continue to do better."

5. **Show Empathy:** Just like showing appreciation, showing understanding and compassion is just as important. Sometimes good interaction skills just mean lending someone your ear or letting them vent. Don't just see them as a customer with problems; see them as a valued partner. That may mean that a nurse spends extra time with his/her patient as he/she shares a personal story, whether or not it is relevant to the patient's treatment. When it comes to tips on how to interact with customers, showing empathy is a winner as It can be just acknowledging a customer's frustration on the phone and simply responding with, "I can see why that made you angry." Align yourself with your customer, listen actively to build a rapport, and reassure them. They are the lifeblood of your business after all. They need to feel respected and heard.

6. **Make Interactions As Easy As Possible:** Whatever industry you're in, convenient, easy and smooth interactions with customers work best as every dialogue, across interactions and transactions, should be consumer friendly for true good customer interaction. For example, redesign your websites "contact us" page so it's easier to find or add a map for directions. Another example is adding several payment methods such as all credit cards and digital wallets, or even accepting payment plans. Amazon founder and CEO Jeff Bezos once said, "We are never competitor based or obsessed we are always customer based and obsessed. We work in a backward workflow and we always begin with our customer needs and then build the framework." That's what you call good customer interaction.

7. **Promote Customer Loyalty:** Listen to customer's feedback as you continue branding your company so that your business is always relevant and aligned with your target audience. By knowing your customers you can improve on how to interact with customers and your customers should have a direct link to providing their opinions, observations and complaints, and sharing ideas on improvement. You can have a focus group, try pilot programs or beta testing, or create campaigns for new product ideas, like Starbucks has done in the past. According to the

HBS Digital Initiative in 2008, “My Starbucks Idea” was launched to increase the focus on what customers want and by 2013, the coffee giant had generated over 150,000 ideas from consumers and actually created 277 of those ideas. Starbucks Cake Pops, Hazelnut Macchiato, and free Wi-Fi were all thought of by the general public not the corporation.

8. **Empower Customers:** Starbucks isn’t the only corporation empowering customers by giving them a forum to share thoughts, concerns, and engage more with the brand. The LEGO Group also joined in for answers on how to create a more sustainable future. CEO Niels. B. Christiansen said, “As a company who looks to children as our role models, we are inspired by the millions of kids who have called for more urgent action on climate change. We have received many letters from children about the environment asking us to remove single-use plastic packaging.”Empowering customers for the LEGO Group led to a $400 million investment over three years to accelerate sustainability and social responsibility initiatives.

9. **Understand Customers Expectations:** If your brand makes promises you better make sure your business delivers those promises and when honing how to interact with customers you want to align every expectation with its own response. If your website boasts a two-day delivery. However, due to backlogs with the third-party shipment company you employ you know that now it will take two weeks and you want to make sure you advertise that on your webpage or even social media. Having good customer interaction skills means managing expectations being realistic and communicating frankly with customers so they can act or react appropriately that is called a good customer interaction.

10. **Cultivate A Good Culture:** Corporate culture is not only internal, it carries over to customers too and it is important to identify your own version of customer culture first so your employees and colleagues can be on the same page. Show how the various functions and operations of

the company are impacted by a customer-centric strategy. When it comes to how to interact with customers, every business has its own unique formula depending on their industry, size, and goals but the fundamentals of good customer interaction are all the same. Appreciate your customers, be honest with them, address concerns, resolve issues quickly, and keep them engaged with your brand. After all, they're your partners in success.

2.6 CONCEPT OF TIME VALUE OF MONEY (TVM)

The time value of money (TVM) concept reveals that a sum of money is worth more now than the same sum will be at a future date due to its earnings potential. This is a core principle of finance. A sum of money in the hand has greater value than the same sum to be paid in the future. The time value of money is also referred to as present discounted value. It is a theory advantage of having money today then latter. It is the concept that the value of a rupee to be received in coming future is less than the value of rupee today. It is a concept, which states money available now has worth more than the same amount of money in future due to its earning capacity. Investors prefer to receive money today rather than the same amount of money in the future because a sum of money, once invested, grows over time.

For example, money deposited into a savings account earns interest and over a period of time, the interest is added to the principal, earning more interest. That's the power of compounding interest. If it is not invested, the value of the money erodes over time. If you hide $1,000 in a mattress for three years, you will lose the additional money it could have earned over that time if invested. It will have even less buying power when you retrieve it because inflation has reduced its value. As another example, say you have the option of receiving $10,000 now or $10,000 two years from now. Despite the equal face value, $10,000 today has more value and utility than it will two years from now due to the opportunity costs associated with the delay. There are various reasons behind this concept:

1. **Investment:** Money can be invested for generating more money, so money received today has greater value.

2. **Interest Earning:** Value of rupee currently is more than its future value, as it is expected that it can be A rupee today is worth more today than in future because of its opportunity cost of lost earnings.

3. **Inflation:** It is expected to increase in price of commodities in coming future due to inflation, which lead to decline in value of today's money. "Positive rate of Inflation reduce the purchasing power of rupee with passage of time".

4. **Risk:** When someone lends money, there is a risk involved in not paying back the money. Because of that risk interest is charged on the money, which reduces value of money.

Terms attached with Time Value of Money

1. Present Value: It is a series of future payment or future value discounted at a rate of interest up to the current date to reflect the time value of money and result is called present value.

2. Future Value: It is amount that is calculated by increasing present value or series of payment at the given rate of interest and result is future value.

3. Rate of Interest: It is a charge against use to inflate/discount present value / future value to achieve desire result.

4. Time Value of Money Principle: It is used to compare two different cash flow statements of two different companies or projects for investment. Purpose is to state return provided by them if we make investment now.

5. Number of Periods: it represent the time period to which value or payment series discounted / inflated to calculate appropriate return.

Formula of TVM

The most fundamental formula for the time value of money takes into account the following: the present value of money, the future value of money, the interest rate, the number of compounding periods per year, and the number

of years. Keep in mind, though that the TVM formula may change slightly depending on the situation. For example, in the case of annuity or perpetuity payments, the generalized formula has additional or fewer factors. The time value of money doesn't take into account any capital losses that you may incur or any negative interest rates that may apply. In these cases, you may be able to use negative growth rates to calculate the time value of money. Based on these variables, the formula for TVM is: FV=PV(1+i/n) n×t

Where, FV = Future value of money PV = Present value of money

i = Interest rate

n = Number of compounding periods per year t = Number of year

EXAMPLE: Assume that Mr. X is investing $200,000 for 3 years at the interest rate of 4% compounded semi-annually. What would be the amount received by Mr. X three years later? The value provided in the question are as follows:

PV = $200,000 i = 4%

t = 3

n = 2

The amount to be received at maturity of the investment is calculated as follows,

FV=PV[1+(i/n)](n×t)

FV=$200,000[1+(0.042)](2×3)

FV=$200,000[1.02](6)

FV=$200,000×1.1261624

FV=$225,232.48

Therefore, by investing $200,000 today, Mr. X can earn $225,232.48 at the end of three years.

1. **Present Value (PV):** The present value is known as the current value of a sum of money that we will receive in the future. We have mentioned

that the purchasing power of money reduces over time. The formula of PV accounts for this reduction by applying a discounting rate to the sum that we will receive in the future. Due to the use of the discounting rate, the process of calculating the present value of a sum of money is also known as discounting a sum of money. The PV of a sum of money can be used to determine the current value of projected cash flow from a bond, an annuity, a loan, or any such instance where you are supposed to receive money from a third party in the future and you want to know exactly how much that money will be worth today.

2. **Future Value (FV):** As the name goes, the FV denotes the value of a sum of money at some date in the future. This calculation is useful for investors and businesses who want to know the future value of their potential investments to make a good investment decision.

2.7 SIGNIFICANCE OF TIME VALUE OF MONEY

The time value of money is the foundation of investment decision-making, so to speak. By now you have realised that the value of the money you hold presently will not be the same in the future. This may prompt you to invest to increase your current wealth and build it into a substantial corpus so that you can avoid the brunt of inflation and rising costs. It is mostly used concept in Finance world based on this, decisions are made to maximize return on investments. It helps shareholders to invest their fund wisely. Its concept contributes to this aspect to much extent. Its significance are as follows:

1. **Investment Decision:** The principle of TVM acts as a guide for you to evaluate the appeal and appropriateness of different investment instruments and business opportunities. When you are able to compare potential risks versus returns, you can make informed decisions.This is decision to make investment of funds for long term purpose. It help us to identify long term cash flow statements which will occur at different point of time. So, if investor have two projects to invest its money in, those two projects can be compared with this technique even if their cash flow statement time period doesn’t matches with each other by

providing present value of their future cash flow. Its concept is mostly used in equity or debt securities investment by using valuation models while doing investments.

2. **Financing Decision:** This is the decision to optimize capital structure of the organization. TVM helps in this decision by comparing cost to company through usage of effective rate of interest of each source of finance. And then present value of costs of two alternatives is compared against each other to decide on appropriate source of financing. It also helps investors to set realistic financial goals and decide amounts to invest or save to fulfil financial objectives.

3. **Operational Decision:** This concept is also used in evaluating creditor cycle and debtors' cycle in managing cash collection under current assets management and when it comes to taking loans, TVM enables borrowers to assess the real cost of borrowing, while lenders can decide on appropriate rates of interest. Time can literally wreak havoc on your wealth, and the most important way that TVM helps investors is in terms of considering the potential effect of changes in interest rates and the impact of inflation.

2.8 APPLICATIONS OF TIME VALUE OF MONEY (TVM)

The idea of the time value of money is often considered to be the cornerstone concept of the study of finance. TVM can help investors and savers understand the value of money today relative to its earning potential in the future. TVM is critical to understanding the effect that inflation has on money and why saving your money early can help increase the value of your savings dollars by giving them time to grow and outpace the effects of inflation. Of course, it is important to remember that there will always be possible options that are sacrificed with every option you decide on and every choice you make.

1. **Project selection:** Time value of money is most importantly used in discounting cash flow analysis. Before selecting any project, the cash flows that will be generated during the lifetime of the project are listed.

These cash flows include both cash inflows and cash outflows. The future cash flows are discounted using the TVM formula and the present value of these future cash flows is identified. The initial investment and the discounted cash flows are added to identify the Net Present Value (NPV) of the project. This may be done for multiple projects and the project with the highest net present value is selected by companies. Therefore, TVM is important in management decision-making as well. While NPV is one of the methods used to select a project, companies may also use the internal rate of return method (IRR). In the IRR method, the cash flows are discounted similarly to NPV. The rate of return is identified by equating the sum of discounted cash flows and initial investment to zero.

2. **Sinking fund:** Finance managers of companies may decide to set aside an amount in case of redemption of debentures in the future. The future value that is required for redemption is set. However, the funds that must be periodically set aside for the sinking fund must be decided based on the compounding interest rate. This amount can be calculated using the formula of the time value of money. Sometimes a financial manager is faced with a decision to collect a specified sum on a periodic basis at a specified rate to reach a prescribed target amount. For example, a financial manager has a target to have a sum of Rs. 1,00,000 after ten years. Now the question arises that if a compound rate of 10% is available then what amount shall be allocated or provisioned every year so that at the end of 10th year, the finance manager would have Rs. 1,00,000 available with him. This kind of situation normally arises in case of redemption of debentures. For example, if a company has to redeem its debenture after 5 years for which it requires Rs. 5,00,000. Now the manager will have to work out the amount which shall be retained out of the profits of the company every year and invested at a specified rate on compounding basis so that after 5 years it shall have the target amount of Rs. 5,00,000.

This can be worked out using the formula given below:

Future value = annuity amount*CV AF (r, n)

Annuity amount = Future value/ CV AF (r, n)

In this case, r and n represent rate of compound interest and number of years respectively

In the above example, if we assume that the rate of interest is 8%, then annuity amount would be given as:

Annuity amount = 5,00,000/5.867

Annuity amount = 85222.43

3. **Capital recovery:** The loans obtained by companies must be repaid in specific instalments. Upon identifying the number of instalments, the size of instalments must be identified. That is, the amount that will be paid back in each instalment must be calculated. This can once again be done using the formula of the time value of money. When a firm takes loan from financial institutions, it may be required to pay the same in form of specified periodical instalments. In order to determine the size of instalments, the financial manager may use the under-mentioned formula provided the rate of lending is. known to the financial manager.

   For example, A company borrows a loan of Rs. 5,00,000 which is to be repaid in form of five equal instalments. Now if the given compounding rate is 12%, the amount of each instalment would be given as:

   Annual amount = 5,00,000/3.605

   Annual amount of instalment = 138696.25.

4. **Deferred payment:** A company after obtaining a loan need not start paying interest immediately. The interest can accumulate, and the company can start repayment even after two years. This delayed payment of interest is called the deferred payment. The loan obtained would change in value over two years because of the time value of money. Therefore, to calculate the annual instalment amount, the formula of TVM can be used.

Sometimes there is a gap of certain years between the date of borrowing and date of commencement of repayment of interest. This is known as deferred payment. For example, in the above case if the repayment of interest process is started after two years of raising the loan, then the amount to be refunded in the form of interest will be5,00,000 (1 + 12%)2 = 5,00,000 x 1.254 = 627,000

Now for the purpose of calculating annual amount of instalment, the amount of loan would be considered as Rs. 627,000

Annual amount of instalment = 627,000/3.605

Annual amount of instalment = 173,925.10

Example: Vijay borrows from Kings Bank an amount of Rs. 10,00,000 @ 12% p.a. on 01.04.2012. As per agreement, repayment including interest is to be made in five equal annual instalments with first instalment falling due after three years i.e. on 31.03,2015. What would be the amount of each instalment?

Solution : First we shall calculate future value of Rs. 10,00,000 @ 12% after two years as shown below:

FV = 10,00,000 (l + 12%)2

FV = Rs/ 12,54,000

Now this will become amount of loan and the size of instalment will be calculated as under:

12,54,000 = A x 3.605

A = 12,54,000 / 3.605

A = Rs. 3,47,850

5. **Implicit rate of return:** Finance companies offer certain schemes where a large amount of money is invested at the beginning of a period and the return on investment is given back to the investor periodically in the form of an annuity. The time value of money can be used in calculating the value of the annuity and the interest rate. Sometimes various schemes are offered by finance companies under which a person is required to

deposit a specific sum in the beginning of a period and then return is available to him in the form of annuity for a certain number of years. The investor would like to calculate the rate of interest available to him in case of such scheme for which the following formula can be used

PV = Annuity amount x PV AF (r, n)

For example, Rs. 20,000 is deposited or invested today and against this the investor is being offered an annuity of Rs. 5,000 for next five years. In this case, in order to find out the rate of interest being offered to the investor can be calculated using the above formula

20,000 = 5,000* PV AF(r,n)

PVAF (r,n) = 20,000/5,000 = 4

the interest corresponding to value '4' against 5th year. The interest rate is 8% (approx.) as corresponding to 5th year for 8%, the value is 3.99 i.e., closest to 4.

2.9 SUMMARY

The lesson helps you to know the importance of client interaction because it is said that your customers have high expectations and if your business cannot meet them, they are going to leave you for your competitors. "If that sounds harsh, well, it is. In addition to getting a product or service that works for them, they want to buy from companies that make it easy to get help when they need it, that go above and beyond for them, and that make them proud to support their corporate culture and philosophy."You already know that the customer experience doesn't end with a sale it's an ongoing work in progress that companies should be constantly seeking to improve and iterate on. Customer interactions are instances when people communicate and engage with businesses. These moments occur throughout the customer journey and typically relate to marketing campaigns, sales promotions, and service- related issues. The value of money held today is worth more than the same amount of money in the future. In simple terms, the value of INR 1,000 was worth more yesterday than today. With time, factors like inflation affect the value of money. This

lesson explains the Time Value of Money concept in detail and its importance. From a business perspective, the money can be used for the expansion of the business, which can generate more money. The future is always uncertain therefore, better financial decisions can be taken with the time value of money and one can assess the debt position of a business with the help of the time value of money.

2.10 GLOSSARY

- Present Value: It is a series of future payment or future value discounted at a rate of interest up to the current date to reflect the time value of money and result is called present value.
- Loyalty: A person's devotion or sentiment of attachment to a particular object, which may be another person or group of persons, an ideal, a duty, or a cause.
- Empathy: It is the ability to emotionally understand what other people feel, see things from their point of view, and imagine yourself in their place.

2.11 SELF-ASSESSMENT QUESTIONS

Q1. How does client interaction works? Explain.

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Q2. Discuss various applications of TVM.

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Q3. Why is the Time Value of Money Important?

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2.12 SUGGESTED READINGS

- 7 Best Practices to Handle (and Ace) Customer Interactions by Aayushi Sanghavi
- Time value of money: A case study on its concept and its application in real life problems by Mohammad Rahman
- https://learn.g2.com/customer-interaction#customer-interaction-cycle
- https://www.liveagent.com/customer-support-glossary/customer-interaction
- https://marcuslemonis.com/business/positive-customer-interaction
- https://www.bartleby.com/subject/business/finance/concepts/application-of-time- value-of-money-tvm
- https://www.investopedia.com/terms/t/timevalueofmoney.asp

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UNIT-I **LESSON NO. 3**

FINANCIAL PLANNING

CASH FLOW AND DEBT MANAGEMENT WITH ASSET ACQUISITION

STRUCTURE

3.1 Introduction

3.2 Objectives

3.3 Concept of Cash Flow and Debt Management

3.4 Cash Flow Management

3.5 Debt Management

3.6 Strategies for Managing Debt and Cash Flow

3.7 Developing Trends and Innovations in Cash and Debt Management

3.8 Asset Acquisition

3.9 Benefits of Asset Acquisition

3.10 Types of Asset Acquisition

3.11 Factors to be Considered in Asset Acquisition

3.12 Summary

3.13 Glossary

3.14 Self-Assessment Questions

3.15 Suggested Readings

3.1 INTRODUCTION

Cash and debt management (CDM) functions of a Ministry of Finance (MoF), explains the importance of interaction and coordination between them, and sets out how this can be best achieved under various institutional structures and here we discusses the CDM items in combination, it approaches the interactions primarily from the perspective of cash management and the wider treasury even international experience has favoured more recently the structuring of both functions in one unit because of efficiency, both in developing a consistent policy stance and operationally. It appears, however, that the integrated structure is particularly useful when there is a certain level of market development and when the CDM functions are active and well developed. In any case, a good coordination mechanism is essential so the performance of CDM in institutions throughout the region is assessed which includes the annual borrowing plan preparation; treasury single account (TSA) management and monitoring; cash surplus investment; cash flow forecast preparation; treasury bond (T- bonds) and treasury bill (T-bills) issuances, as well as corresponding auction calendars; risk management and analysis; market and investor relationships; and accounting and statistical report preparation. Although most of these functions are performed by the CDM offices in the region, active cash management is not prevalent in many countries. This may explain why only three countries (Brazil, Colombia, and Peru) have adopted integrated offices, given that financial markets that are less developed and have less active cash management do not require integration between the two functions.

3.2 OBJECTIVES

In this lesson, you will be able to understand:

- Concept of cash flow and debt management
- Functions of cash flow and debt management
- Strategies for managing debt and cash flow
- Concept of assets acquisition

- Types of asset acquisition
- Benefits of asset acquisition

3.3 CONCEPT OF CASH FLOW AND DEBT MANAGEMENT

The goal of any business setup is to earn profit and many people do wish to start their own businesses. However, they need to learn how to make the business profitable in the long run so they take huge loans from banks and other institutions and invest their savings, only to shut down. The most common reason here is due to unstable cash flow and a lousy debt management plan. One can start a business without debt but they have to rely on external funds to develop and expand their reach across the market. Properly managing your cash and debt is the foundation of financial stability and independence. Maintaining an emergency fund and suitable cash flow needs will allow you to meet your savings or spending goals. Additionally, in retirement, it may be important to maintain a "portfolio income buffer" to insulate your retirement income from the volatility of the markets.

3.3.1 CASH FLOR MANAGEMENT

It is the process of planning, tracking, and controlling the movement of cash in and out of a business that involves forecasting future cash needs and ensuring that there are sufficient funds available to meet these needs, as well as managing any excess cash in a way that maximizes its value. Cash flow management is an important aspect of financial planning and can help a business to stay financially stable and avoid financial challenges, such as bankruptcy or default on loans. Some common strategies include forecasting cash flow, reducing expenses, increasing revenue, and optimizing the timing of payments and receipts. It also tracks and coordinates a company's past, present and future expenses which helps to ensures that an organization is paying its invoices on time, adequately compensating staff with room for salary growth, and managing funds for future investments. A concrete understanding of the way cash flow affects business not only minimizes the risk of closure,

but can ensure continued success and increased revenue rates. But all of this is only possible when a company has full transparency into their finances.

3.3.2 DEBT MANAGEMENT

Debt is one of the realities of business even if your customers pay within the allocated terms, it's your business that is carrying the risk. Many businesses avoid thinking about debt until they are in a position where they are faced with a potentially ruinous situation of a large debt and insufficient capital to keep the business operational. While no one could suggest dealing with outstanding debts is the nicest part of running a business, a consideration of the process and the options available to you will help to reduce the stress and uncertainty of such situations. If the communication is open and ongoing then it is probably better to negotiate your way through the resolution of the debt between yourself and your customer. Although if any extended terms are agreed, it would be sensible to have these documented and agreed by e-mail as an added item on the paper trail but if you find that the communication has broken down, the client is avoiding your calls, e-mails, etc. and has not made contact to conclude the matter, you will need to consider your next stages in the form of professional help. In broad terms, firms which offer debt recovery services can be either debt collection agencies or law firms with a debt recovery service. As a business owner it is important to bear in mind that debt can be a fact of life that needs to be managed effectively so it is always suggested that engaging the legal route simply as this is a professional service that provides options at each stage. In all cases you need to act as soon as it is apparent that you cannot resolve the matter yourself in a reasonable manner or timescale remember that there is a good chance that if this client has not paid you, they may have a string of creditors chasing them for outstanding invoices.

3.4 STRATEGIES FOR MANAGING DEBT AND CASH FLOW

Cash flows and the debt of business are interrelated as the financial health is a delicate balancing act between debt management and cash flow. The two are interwoven, intertwined, and cannot be ignored. Think of it like a game of Jenga; one wrong move and everything can come tumbling down so, when your cash flow is abundant your need for external funding is lessened. But when you're dealing with negative cash flow or coupled with mounting debt, things can go downhill faster than a toboggan on a snowy hill. Building a solid financial foundation takes time and effort, but it's worth it to avoid the potential disaster of losing everything you've worked hard to achieve. So, every successful company will have a solid debt management plan and multiple income sources to finance their company and their loans that prevent it from financial threats and here are some strategies they can replicate:

1. **Extensive Cash Flow Monitoring:** The first point is to ensure you are not overspending or underutilizing your company funds. Monitoring involves making cash flow forecast models, analyzing financial statements, etc. For instance, you can cut unwanted costs in the manufacturing process, make efforts to boost sales, etc. Your goal should be to increase the inflow of money and control the outflow subsequently.

2. **Debt Consolidation:** Want to know how to reduce debt effectively? Consolidation is one method you can consider. What happens here is that you combine all your debts into a single one so you can make manageable payments. An added advantage is you could get the interest lowered. It's better to consult with an advisor before you do this.

3. **Budgeting:** You cannot survive in the market if you don't have a proper budget. It is a process where you set aside specific funds based on anticipated expenses. This is a great way to set priorities for using the money and reduce unnecessary spending. In return, you can make better cash flow and debt management decisions.

4. **Negotiation:** Creditors are aware that they may need more time to get their funds. However, they'll be free to negotiate with you if you have a history of paying back your debts on time. If you succeed, you can reduce the amount of interest, extend the payback period or even settle the whole debt for less than the amount you borrowed.

5. **Using Cash Flow to Reduce Debt:** Use your own money rather than take another loan. You can achieve this by optimizing your cash flow to have sufficient money. First, wire your money to a separate account to settle expenses like EMIs.

3.5 DEVELOPING TRENDS AND INNOVATIONS IN CASH AND DEBT MANAGEMENT

A centralized payments system can provide benefits to accounting, recording, and reconciling bank statements. Government use of commercial banks to provide retail banking services can make transactions more effective and efficient; reduce the use of cash for government transactions; reduce opportunities for corruption and allow rapid, regular computerized bank statement reconciliations. It also releases the central bank from a role that it cannot perform competitively having only one customer and little incentive to account transparently for its profit and loss on such business. Governments can realize many benefits by using these modern banking and payments systems.

1. **Public Cash Management:** The advantages of successful active cash management are clear and the government is sure that its public policy priorities can be implemented without the risk of cash shortages restricting or rationing expenditures leading to payment arrears. Net short-term borrowing costs are reduced to a minimum, and surplus cash is invested to earn a market-related interest rate. Fiscal risks are contained to the extent possible by contingency buffer reserves of cash, and monetary policy is not adversely affected by government's financial market activities. Cash planning is the process by which a government forecasts its cash availability and cash needs for a future time span often the fiscal year, and in more detail over shorter periods. Cash management

defines those activities undertaken by the government cash manager to ensure that financing is in place to meet the government's spending obligations and that identified cash surpluses are put to the most efficient use consistent with the defined risk parameters.

2. **Government Banking Arrangements and Payments Systems:** Maintaining a treasury single account is now considered a prerequisite for effective cash planning and today many governments automatically stream their revenues and expenditure payments through a TSA. The concept is simple although hardly new. It dates from the British colonial era when it was originally devised as a single actual bank account rather than the accounting ledger it is considered to be today. Although the concept may not be new but the introduction and implementation of a TSA is certainly an innovative and often challenging process especially in emerging market economies and developing countries.

3. **Cash Planning:** Many countries are now following the lead of developed governments by establishing a cash management unit (CMU) and sometimes attached to the DMO, which has the responsibility to perform cash planning and active cash management. Technological advances in computerized budget management have greatly assisted the cash manager in forecasting available government cash resources. Whether a fully-fledged FMIS or a spreadsheet budget model is used, a transferable database containing all annual budget allocations can be employed to perform aggregated projections of the TSA balance for the current fiscal year. The degree of complexity that these projections entail may be chosen by the cash planner. Often the basis is a daily projection over the nearest month, weekly for the following two months, and monthly for the rest of the fiscal year. The cash planning model can also be used to simulate short-term cash consequences of fiscal risks that might occur during the year. Senior officials of the ministry of finance or the government can request the cash planner to provide estimates of the liquidity constraints that would arise under certain defined circumstances, such as significant changes to revenue projections,

increased expenditures through public policy changes, crystallization of contingent risks such as guarantees, moral hazard expectations and changes in debt-servicing costs through movements in interest rates and foreign exchange values.

4. **Active Cash Management:** A prerequisite for active cash management is that the CMU's cash plans and forecasts be credible. Credibility is gained when forecasts have compared favourably to actual expenditure outcomes over a significant period. At the stage when such credibility is evident, the committee or body controlling the CMU is in a position to give the CMU authority through regulations enacted for this specific purpose to perform active cash management operations and transactions. The primary objective of the CMU's cash planning exercise is to estimate the expected balance in the TSA during the period ahead before any cash management activity takes place. This bank balance profile, covering as it must the whole of government cash resources available for budgetary purposes, normally shows large swings between positive and negative territory. The secondary objective of the CMU is to make this profile after cash management operations as stable and close to a target level as possible.

5. **Public Debt Management:** Debt management is the framework, system or process that allows the required amount of government funding to be raised in a manner consistent with governments risk and cost objectives and any other debt management goals. The increased borrowing levels in advanced economies in the 1980s, as well as the large infrastructure and financing needs of emerging market economies following the breakup of the Soviet Union in the early 1990s, were undoubtedly catalysts for a greater focus on debt management shows the significant growth in the sum of all countries' public domestic debt securities since the early 1990s. The large financing requirements created awareness of the importance of debt management operations to long-term fiscal sustainability and efficiency of the public financial management system. The increased complexity of financial markets and the instruments that

were developed also led to awareness of the need to professionalize the debt management function because general civil service skills were no longer sufficient to manage such complex portfolios.

3.6 ASSET ACQUISITION

Asset acquisition is a way to obtain ownership or control of assets such as property, equipment, and intellectual property. It means purchasing these assets from another party with either cash or an exchange of other assets. Businesses do this to expand their capabilities, to be more competitive, or to enter new markets. There are many reasons to acquire assets that includes; strengthening product offerings by obtaining a competitor's tech, or getting real estate to enter a new geographic area. Basically, it gives companies the strength and resources to grow and develop. For example, Facebook bought Instagram in 2012 this gave them access to a huge user base and new features, which fit their social media network and also increased their reach and stopped potential competitors.

In other words we can say that asset acquisitions are when a start-up purchases a company for its assets rather than its equity or shares. Shareholders can claim some of the company's residual earnings if the new owner dissolves or sells it in the future. It is essential to be specific about the assets and liabilities to reduce potential losses and in most jurisdictions, an asset acquisition typically also involves an assumption of certain liabilities. However, because the parties can bargain over which assets will be acquired and which liabilities will be assumed, the transaction can be very specific in its structure and outcome than a merger, combination, or stock purchase. Managing acquired assets requires knowledge of their unique traits and maximizing their worth. This means doing assessments to find areas for progress, setting up integration plans, and streamlining operations for better performance. It also involves tracking key performance indicators to make decisions about resources.

3.7 BENEFITS OF ASSET ACQUISITION

By adding new assets, businesses can upgrade their existing

infrastructure or equipment that resulting in improved productivity and smoother processes which boosts performance and keeps businesses ahead of the competition. To understand the importance of asset acquisition, delve into the benefits it brings and discover how asset acquisition can have a positive impact on your business and help you achieve your goals.

1. **Asset acquisition also sparks innovation and growth:** Investing in modern technologies and equipment lets businesses stay up-to-date and adjust to market trends. With the right assets, businesses can explore new opportunities, create innovative products or services, and attract more customers.
2. **Asset Acquisition saves Money in the Long Run:** Though the initial expense may seem big, owning assets rather than renting or leasing them cuts recurring costs. Plus, owning assets gives better control over quality and maintenance, reducing the risk of expensive repairs or downtime.
3. **Asset Acquisition shows Businesses are Industry Leaders:** Valuable assets build credibility and boost customer and investor trust. It shows a commitment to first-rate products or services, as well as a strong financial standing that attracts potential partners or stakeholders.
4. **Asset acquisition increases operational efficiency:** By adding new assets, businesses can upgrade their existing infrastructure or equipment that resulting in improved productivity and smoother processes which boosts performance and keeps businesses ahead of the competition.

3.8 TYPES OF ASSET ACQUISITION

To understand asset acquisition we have to know about the various types of asset acquisition that helps to gain insight into the various solutions for acquiring assets efficiently and effectively.

A. Mergers and acquisitions: The term mergers and acquisitions refers to the consolidation of companies or their major business assets through financial transactions between companies. A company may purchase

and absorb another company outright merge with it to create a new company and acquire some or all of its major assets, make a tender offer for its stock, or stage a hostile takeover. Both companies involved on either side of an M&A deal will value the target company differently. The seller will obviously value the company at the highest price possible, while the buyer will attempt to buy it for the lowest price possible.

Mergers and acquisitions have many objectives that includes:

- growing customer base
- offering diverse products
- entering fresh markets
- improving competitive edge

B. Joint ventures and partnerships: Joint ventures and partnerships can unlock many benefits like pooling resources, leveraging each other's strengths, and sharing costs and risks that can help organizations to reach new markets and increase their market share. An inspiring example of this is two automotive companies who joined forces to develop electric vehicles. They shared research, technical expertise, and manufacturing capabilities to bring cutting-edge products to market faster. This collaboration not only boosted sales, but also contributed to environmental sustainability. Strategic alliances can be a powerful tool for growth and success. Thus, one should consider exploring them.

C. Purchasing fixed assets: When we talk about purchasing fixed assets this type of acquisition helps a company to identify the needs that determine what resources are necessary for efficient operations and then evaluate the various options like Research suppliers, compare prices, and inspect the quality and reliability of the assets so that they can plan a budget that fits the company's financial capabilities

3.9 FACTORS TO BE CONSIDERED IN ASSET ACQUISITION

When we talk about acquiring assets of a company there are certain factors that should be considered and those are given below:

1. **Financial considerations:** Acquiring assets requires examining various financial aspects and consider the cost, cash flow effect, and return on investment. Analyze the seller's financial stability and the asset's depreciation also evaluate any liabilities or debts linked to the asset. One can do a due diligence to find and address risks and should consider financing options, like loans, equity investments, and leasing.

2. **Legal and regulatory aspects:** The legal and regulatory aspects of asset acquisition are essential and a company should understand that adhering to the laws and regulations is the key for a successful acquisition. Intellectual property rights must be assessed and protected that helps to identify any patents, copyrights or trademarks associated. Failing to protect these rights could result in legal disputes and losses. Tax implications of asset acquisition are also important. Different jurisdictions have varying tax laws which can affect the overall financial structure. Seeking professional advice can help minimize tax liabilities and maximize benefits.

3. **Market and industry analysis:** When acquiring assets, one must do is conducting a thorough market and industry analysis and examine prevailing conditions to know the dynamics of the assets industry. Analyze consumer demand, competition and trends for valuable insights. Assess the market size and potential for growth. Also evaluate the competitive landscape, including players' strengths and weaknesses. Analyze industry trends and technological advancements that may affect the asset's performance and be aware of emerging technologies to give you an advantage.

3.10 SUMMARY

In this lesson you are able to know about the relationship between debt and cash flow as we discuss above the development of any successful plan in order to build wealth is to know what you are spending and to determine your overall financial capacity with the help of that you are able to develop an

appropriate plan to achieve your short, medium and long term goals .As part of this process, it is also important to determine, understand and manage debt. You can develop a personalised strategy to help yourself to eliminate bad debt and use good debt sensibly, to build wealth. Remember that debt is only a tool that supports your business. However, having more debt than your equity is like playing with a dual-edged sword. It will cause agencies to give you a bad credit rating if you do not repay your loan on time. This will also affect your present and future cash flows permanently. The range of technological innovations and instruments available to cash and debt managers has increased considerably, but not without creating greater challenges. These include ensuring that proper controls and risk management processes are in place to allow for the achievement of specific debt and cash management strategies within wider fiscal policy objectives. Advanced economies have actively pursued proper processes. Further capacity building will be required in developing countries as their interactions with market-based instruments increases.

3.11 GLOSSARY

- Acquisition: Acquisition refers to the takeover of one entity by another. It is commonly used to refer a company that is acquired by another company and especially used this way in the phrase mergers and acquisitions.
- Debt: Debt can be simply understood as the amount owed by the borrower to the lender. It is the sum of money that is borrowed for a certain period of time and is to be return along with the interest.
- Cash Flow: The amount of cash or cash equivalent which the company receives or gives out by the way of payment to creditors is known as cash flow.
- Budgeting: It is the process of forecasting revenues and expenses of the company for a specific period like the sales budget prepared to make a projection of the company's sales and the production budget prepared to project the production of the company etc.

3.12 SELF-ASSESSMENT QUESTIONS

Q1. Define cash flow and debt management.

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Q2. Discuss various trends and innovations in cash flow and debt management.

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Q3. Explain the types of asset acquisition.

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3.13 SUGGESTED READINGS

- https://nbsl.org.uk/business-bullets/finance/146-debt-management-a-process-for- positive-cash-flow
- https://www.businessfranchiseaustralia.com.au/blog/the-connection-between- cash-flow-and-debt-management
- https://www.wealthmarc.com.au/cashflow-and-debt-management
- https://www.elibrary.imf.org
- https://www.bizmanualz.com/library/asset-acquisition
- https://www.investopedia.com/terms/m/mergersandacquisitions.asp

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UNIT-I **LESSON NO. 4**

FINANCIAL PLANNING

OVERVIEW OF RISK MANAGEMENT AND EDUCATIONAL, INVESTMENT AND RETIREMENT PLANNING

STRUCTURE

4.1 Introduction

4.2 Objectives

4.3 Concept of Education Planning

4.4 Principles of Education Planning

4.5 Types of Education Plans

4.6 Concept of Risk Management

4.7 Principles of Risk Management

4.8 Techniques of Risk Management

4.9 Concept of Investment Planning

4.10 Objectives of Investment Planning

4.11 Importance of Investment Planning

4.12 Concept of Retirement Planning

4.13 Importance of Retirement Planning

4.14 Advantages of Retirement Planning

4.15 Factors to Remember while Planning for Retirement

4.16 Summary

4.17 Glossary

4.18 Self-Assessment Questions

4.19 Suggested Readings

4.1 INTRODUCTION

Planning is the process of thinking regarding the activities required to achieve a desired goal. It is based on foresight, the fundamental capacity for mental time travel. The evolution of forethought, the capacity to think ahead, is considered to have been a prime mover in human evolution. Planning is a fundamental property of intelligent behaviour which involves the use of logic and imagination to visualise not only a desired end result, but the steps necessary to achieve that result. An important aspect of planning is its relationship to forecasting.

Forecasting aims to predict what the future will look like, while planning imagines what the future could look like. It focuses on future while drawing enlightenment from the present. It's a dynamic concept which provides a reasonably detailed update of information in order to link the past with the present. It requires embracing changes that society faces. Planning according to established principles is a core part of many professional occupations, particularly in fields such as management and business. Once a plan has been developed, it is possible to measure and assess progress, efficiency and effectiveness. As circumstances change, plans may need to be modified or even abandoned. Everybody has to make financial decisions at some point in their lives. These choices might be as straightforward as selecting bank accounts and credit cards to as sophisticated as selecting investment products and retirement planning. The latter is particularly crucial because it has an immediate impact on retirement quality of life and spending capacity. Retirement planning imposes a series of decisions on average individuals under the increasingly popular Defined Contributions retirement income arrangements, including

selection of retirement fund, investment option, and use of financial counsel, retirement age, and kind of retirement benefit. An individual works for long years and saves bit by bit to gain security in his old age, once he stops earning. So, retirement refers to the time of life when one chooses to leave his work life permanently. There is no particular age, a person may retire at any age he pleases to. But commonly retirement is the result of either bodily incapacity or eligibility for pension benefits. It means planning beforehand for the life after one stops working for his livelihood. It includes determining the sources of income while in the working life and its proper utilization.

4.2 OBJECTIVES

In this lesson, you will be able to understand:

- Concept of Educational Planning
- Concept of Investment Planning
- Concept of Retirement Planning
- Importance of these planning
- Overview of risk management

4.3 CONCEPT OF EDUCATION PLANNING

Planning is part of a hierarchy which ultimately determines how an education system functions. Typically, a country's Constitution prevails over any other legislation, regulations and directives. Following the Constitution, education ministries are then required to comply with other legislation such as regulations over financial management and disbursement; as well as directives and agreements issued under legislation. Planning in education helps to ensure that the quality of education provided meets the challenges of the global world. i.e. it makes learners aware of the effects of global social, economic and technical changes.

Education planning is a very broad and complex process. This module focuses on the national education sector plan and considers its relationship with other key national and regional documents. Education sector planning is

important for development partners, as the education sector plan typically underpins the formulation of partnership approaches and the selection of programming options. This module provides a foundation to engage in this topic and apply advice from staff with operational or expert levels of knowledge in education. On successful completion, you will be an informed participant in forums related to education planning. Educational planning is a process in which each college student is involved in self- assessment, exploring, and integrating academic and career alternatives, and making decisions that are personally relevant for the present and the future.

It involves many important tasks that eventually incorporate a set of short term and long-term goals but certain conditions must be present before an educational plan can be of optimal value:

- Students need a personal commitment and involvement in formulating a plan. If the plan is initiated by them and has relevance for them, it will provide a blueprint for an important period in their lives and have profound influence on their future. They will also take responsibility for its outcomes.
- Students must be aware of the need for flexibility in carrying out any plan. Nothing remains static, and plans may need to be altered as new information or events indicate a change is desirable or necessary.
- Students should be able to articulate their reasons for being in college and how the degree fits into their career and life goals.

4.4 PRINCIPLES OF EDUCATION PLANNING

The principle of education planning for secondary level involves several key factors that need to be considered to ensure effective and successful learning outcomes for students. By following these key principles educators can create effective and successful learning environments. The key principles include:

1. **Clear Goals and Objectives:** Setting clear goals and objectives is essential for effective education planning. This involves defining what students should know and be able to do at the end of a specific

period of time and identifying the key learning outcomes that need to be achieved.

2. **Curriculum Design:** The curriculum should be designed to meet the learning needs of students at the secondary level. It should include a broad range of subjects and be organized in a way that is easy for students to understand and follow.

3. **Assessment and Evaluation:** Assessment and evaluation play an important role in education planning at the secondary level. It is important to develop appropriate assessment methods to ensure that students are meeting learning objectives and to identify areas where they may need additional support.

4. **Quality Teachers:** The quality of teaching is critical for successful education planning at the secondary level. Teachers should be well-trained, experienced, and committed to helping students learn and achieve their potential.

5. **Learning Environment:** The learning environment should be conducive to learning and support student engagement and motivation. This includes factors such as classroom design, resources, and the use of technology.

4.5 TYPES OF EDUCATION PLANS

Governments use many different types of documents to plan. There are program and project plan documents, short and long term budget documents, strategic and policy analysis documents and many other types of information which may all be considered education planning documents. The following are the most common high level national planning documents which typically guide the development of an education system.

1. **Expenditure Frameworks:** Governments typically lay out their broad financial allocations to each sector and often sub- sectors, in national 'Expenditure Frameworks'. The Expenditure Framework informs and guides the allocations of the national and sub-national budgets to each

area of government. Thus, the government expenditure projections for the education sector are presented in this document. Typically governments plan in three to five year financing windows and so expenditure frameworks are often referred to as Medium- Term Expenditure Frameworks (MTEF). Successful implementation of MTEF is affected by various factors including:

- the extent to which MTEF covers the whole of government
- integration of the various phases of the budget cycle (including the MTEF) with other key policy and planning processes
- forecasts must be current and credible, realism in setting the aggregate resource constraint is a key factor for achieving predictability
- early engagement with the political decision making process.

2. **Strategic (Sector) Plans:** An Education Strategic Sector Plan is a tool to effectively describe the inputs, processes and resulting outputs, outcomes and impacts for the education system as a whole. It assist Ministries of Education and involved stakeholders to prioritise and plan the progressive implementation of legislative mandates, policies and programs in the sector. Strategic Plans are important for effective management, including planning, budgeting, implementation, reporting, monitoring and evaluation. Plans should indicate the likely sequencing of implementation in the period ahead. This is important for guiding implementation and assessing progress. A Strategic Plan should include the activities of development partners and non- government providers, to provide a whole of sector 'story'. Ideally, the Strategic Plan should not simply represent the forward work plan of the Ministry of Education but account for the roles of other actors in the sector.

3. **Operational Plans:** An Operational Plan operationalises a strategic plan. It is typically over a shorter period of time than a MTSP or LTSP. Operational Plans should establish the activities and budgets for each part of the organisation for the next one to three years. They link the strategic plan with the activities that the department or organisation will

deliver and the resources required to deliver them. It usually describes milestones, conditions for success and explains how, or what portion of, a strategic plan will be put into operation during a given operational period, such as a fiscal year. In other words, an Operational Plan is a more practical version of the strategic plan. It usually covers a shorter timeframe and has a more detailed specification of the budget.

4. **Annual Performance Plans:** Many countries also encourage Annual Performance Plans. Annual Performance Plans typically identify the performance indicators and targets that a part of the education system or department will seek to achieve in the upcoming budget year. It is important that these performance indicators and targets are aligned across an institution's annual plans, budgets, in-year and annual reports. In addition, the process for the production of the Annual Performance Plan should be aligned to the budget process.

4.6 RISK MANAGEMENT

Risks can come from various sources including uncertainty in international markets, threats from project failures at any phase in design, development, production, or sustaining of life- cycles, legal liabilities, credit risk, accidents, natural causes and disasters, deliberate attack from an adversary, or events of uncertain or unpredictable root cause and ideal risk management, a prioritization process is followed whereby the risks with the greatest loss and the greatest probability of occurring are handled first. Risks with lower probability of occurrence and lower loss are handled in descending order. In practice the process of assessing overall risk can be difficult, and balancing resources used to mitigate between risks with a high probability of occurrence but lower loss, versus a risk with high loss but lower probability of occurrence can often be mishandled.

Risk management is not merely a professional specialty but it is a basic human instinct. Every day, we all naturally evaluate and aim to minimize the danger to ourselves and others in a wide range of situations: crossing the street, purchasing a home, opening an email from an unfamiliar source. Risk

management is the process of identifying, assessing and controlling financial, legal, strategic and security risks to an organization's capital and earnings. These threats, or risks, could stem from a wide variety of sources, including financial uncertainty, legal liabilities, strategic management errors, accidents and natural disasters. Risk management involves identifying and analyzing where risk exists, and making decisions about how to deal with it. It occurs everywhere in the realm of finance. For instance:

- An investor may choose U.S. Treasury bonds over corporate bonds
- A fund manager may hedge their currency exposure with currency derivatives
- A bank performs a credit check on an individual before issuing a personal line of credit
- A stockbroker uses financial instruments like options and futures
- A money manager uses strategies like portfolio diversification, asset allocation, and position sizing to mitigate or effectively manage risk

4.7 PRINCIPLES OF RISK MANAGEMENT

Risk management is a key part of the investment and financial world. It requires investors and fund managers to identify, analyze, and make important decisions about the uncertainty that comes with reaching their goals. It allows individuals to reach their goals while mitigating or dealing with any of the associated losses. While risk professionals are well familiar with the core principles of risk management risk identification, risk analysis, risk control, risk financing and claims management they are certainly not the only ones to rely on them in their daily thinking and decision-making.

1. **Risk identification:** This first principle is just what it sounds like, What risks are presented to me, my organization, my customers, etc., in the scenario in front of me? As an example, think about riding in or driving a car. You might identify the risk of having an accident due to poor maintenance of the car, failure to keep gas in the tank, speeding, or

driving under the influence. Another identified risk may be the possibility of damaging property either the car itself or someone's property. There is also a risk of financial loss if proper liability insurance is not in place or if the driver gets a speeding ticket, and so forth.

2. **Risk analysis:** This stage involves gathering data and considering the meaning of the data points over a span of time. An analysis of the identified risks begs one to ask: How often could this adverse event happen? And if it does happen, what's the worst way it could turn out? In our car scenario, the worst that could happen is loss of life. Additional analysis may determine that the risk of being in an auto accident is low because the driver is never on the highway or only drives in good weather during daylight, on roads with speed limits of 30 miles per hour or less, in a well-maintained car, etc. The analysis part of the risk management process should take you through several what-if scenarios and help you arrive at the potential frequency and severity of an event.

3. **Risk control:** Risk control offers opportunities to implement solutions that support risk avoidance, prevention and reduction. The risk avoidance technique in our car example would be not to own a car nor ride in a car. In reality, a minimal amount of risk still exists, as you could be hit by a car as a pedestrian or injured while using mass transit, but in certain scenarios, risk can be avoided completely. Risk prevention aims to reduce the frequency or likelihood of the event or loss. This might mean preventing car breakdowns by following maintenance and inspection schedules, keeping air in the tires and gas in the tank, and following all driving laws. Risk reduction aims to lower the severity of a particular loss that has already occurred. For example, it might mean ensuring property damage to another person's vehicle is repaired quickly so the time they are without a car is limited. Effective risk control considers the various strategies already in place and may introduce new measures based on the findings of the analysis.

4. **Risk financing:** This fourth principle focuses on the economics of risk.

Risk financing is a way to cover any financial losses that the implemented risk control techniques did not prevent from happening. In our example, even with all the proper maintenance on the car, safe driving, etc., an accident can still occur. By having appropriate auto insurance, funds are generated by the insurance company to pay for the loss in this case, damage to the car.

5. **Claims management:** Whereas risk financing is about managing the financial impact, claims are about managing the harm done. When a loss occurs, a claim may be filed to recover damages. In the car example, a claim may be filed with the insurance company of the driver at fault to recover for the damage that occurred. If the driver at fault was not insured, a different course of action may be necessary to hold the driver personally responsible for the damage.

4.8 TECHNIQUES OF RISK MANAGEMENT

Risk management is the process of identifying, assessing and controlling threats to an organization's capital, earnings and operations. These risks stem from a variety of sources, including financial uncertainties, legal liabilities, technology issues, strategic management errors, accidents and natural disasters.

1. **Avoidance:** Many times it is not possible to completely avoid risk but the possibility should not be overlooked. For example, at the height of a thunderstorm, Physical Plant may not release vehicles for travel until the weather begins to clear, thus avoiding the risk of auto accidents during severe weather. Some buildings on campus have had repeated water problems in some areas. By not allowing storage of records or supplies in those areas, some water damage claims may be avoided.

2. **Retention:** At times, based on the likely frequency and severity of the risks presented, retaining the risk or a portion of the risk may be cost-effective even though other methods of handling the risk are available. For example, the University retains the risk of loss to fences, signs, gates and light poles because of the difficulty of enumerating and

evaluating all of these types of structures. When losses occur, the cost of repairs is absorbed by the campus maintenance budget, except for those situations involving the negligence of a third party. Although insurance is available, the University retains the risk of loss to most University personal property.

3. **Spreading:** It is possible to spread the risk of loss to property and persons. Duplication of records and documents and then storing the duplicate copies in a different location is an example of spreading risk. A small fire in a single room can destroy the entire records of a department's operations. Placing people in a large number of buildings instead of a single facility will help spread the risk of potential loss of life or injury.

4. **Loss Prevention and Reduction:** When risk cannot be avoided, the effect of loss can often be minimized in terms of frequency and severity. For example, Risk Management encourages the use of security devices on certain audio visual equipment to reduce the risk of theft. The University requires the purchase of health insurance by students who are studying abroad, so that they might avoid the risk of financial difficulty, should they incur medical expenses in another country.

5. **Transfer (through Insurance and Contracts):** In some cases risk can be transferred to others, usually by contract. When outside organizations use University facilities for public events, they must provide evidence of insurance and name the University as an additional insured under their policy, thereby transferring the risk of the event from the University to the facility user. The purchase of insurance is also referred to as a risk transfer since the policy actually shifts the financial risk of loss, contractually, from the insured entity to the insurance company. Insurance should be the last option and used only after all other techniques have been evaluated.

4.9 CONCEPT OF INVESTMENT PLANNING

If you thought investment simply meant saving money, then that may not be accurate. Investment refers to putting your money in assets that appreciate

or are capable of generating returns and it is an activity done to grow your money and not merely save it. For instance, buying stocks that give you dividends or investing in a property whose value will increase. Today, you have several types of investments, like stocks, bonds, life insurance, exchange-traded funds, and real estate, to name a few. Each of these investment options comes with its own objectives. While some provide you security, others enable you to yield returns. Thus, investing is very important for securing your financial future. Through investing, you can achieve all your life goals by earning inflation beating returns. However, to invest, you will need a plan that will guide you in making decisions and help you achieve all your financial goals is known as an investment plan. An investment plan is a tool that will help you design a roadmap towards achieving financial freedom. And if we talk about Investment planning, It is the process of identifying your financial goals and devising a strategy to achieve them as it is designed to help you get clear on how to match your financial resources to your financial objectives. It involves aligning your goals with your financial resources and risk profile to find the best investment products that suit you. Investment planning doesn't end with investing and also includes monitoring the investments at regular intervals. Simply put, an investment plan will help you achieve your financial goals by guiding you throughout your investment journey.

Investment planning is the process of aligning your investments to your goals and your risk profile. By analysing your risk profile, you can understand your true potential in investing. Here's how you can arrive at your true potential in investing. You look for Strengths, Weaknesses, Opportunities and Threats (SWOT):

- In investment planning, your strengths are your income level, job profile and how early you have started investing.
- Your weaknesses can be your liabilities and the number of dependents in the family.
- You can find opportunities in terms of reducing your expenses to the minimum.

- Finally, your investments may face threats from uncertainties like inflation, job loss, theft and medical emergencies.

Benefits of Investment Plans

An investment plan is a tool in the process of financial planning designed to develop an investing strategy to achieve your financial goals. It helps you structure how much cash, stock, bonds, and real estate to invest in to maximize returns. Investment plans come with different benefits. Some of these include:

a. **Family Security**: Investment planning is essential for the security of the family. For instance, if there is anything that happens to the working family member, the investment will help the other family members financially secure.

b. **Efficiently Manage Income:** With an investment plan, the income and expenditure of a person may be managed efficiently.

c. **Financial Understanding:** Having a financial understanding will be easier for an individual to evaluate investments or retirement. Thus, investment planning will help in understanding the current financial situation.

d. **Savings:** An investment plan not only provides for the future but also helps in saving money.

e. **Standard of Living:** The standard of living can be kept up or increased with an investment plan as it will help to have a flow of income even after retirement.

4.10 OBJECTIVES OF INVESTMENT PLANNING

As an investor, you must have a specific goal in mind. These are investment objectives that help you determine what type of investments to make and help you prepare for what lies ahead. Investments are categorised into three primary objectives - safety, growth, and income - along with secondary objectives. Therefore, before you begin to invest, it is essential to understand the investment and its goals to pick the right mix and make informed investments

that best suit your needs. Let us take a look at the different objectives of investment planning:

1. **Offers safety:** Investing planning offers financial safety and security to you and your family by helping you set aside money for your future. Moreover, it also helps you assess your risk tolerance levels and invest in securities that match your risk appetite. This way, you won't be taking too much risk that you can afford.

2. **Generates income:** The primary objective of investment planning is to generate income. It will make your money work for you to fulfil your financial goals. Through investment planning, you can invest in securities that can generate income in the short term and long term, which will help you fund all your goals.

3. **Ensures liquidity:** Every investor must have enough liquid investment to meet any emergency expenses. An investment plan will ensure your liquidity requirements are met without compromising on your long-term goals.

4. **Minimises tax:** There are many investments that will help you minimise your tax outlay. With proper investment planning, you can invest in those securities and enjoy tax benefits. Moreover, when you redeem certain investments, there are tax implications on capital gains or profits. A good investment plan will help you minimise your taxable gains.

5. **Create wealth:** A good investment plan aims at creating wealth by growing your capital. The plan will help you decide where to invest money based on your financial goals, risk appetite, and investment horizon. You can accumulate more wealth in the long term than in the short term. Investing in high-return securities for the long term is more profitable as it will help you create a huge corpus.

4.11 IMPORTANCE OF INVESTMENT PLANNING

Investors have always preferred fixed income securities where the returns are assumed and have compromised on the returns. All investors are risk aversive

but with the changing trend and popularity of stock market returns many of them are taking the risk and investing in equity. Investment planning is a must in today's world without which you cannot fulfil your life goals and sometimes may end up in a financial crisis. If we are taking investment decisions today that will directly affect our future wealth, it would make sense that we utilize a plan to help guide our decisions. There are certain points that help us to know the importance of investment planning:

1. **Inculcates the habit of saving:** An investment plan will help inculcate the habit of saving. By helping you schedule your investment regularly, the investment will increase your financial discipline.

2. **Offers financial security:** Having an investment plan provides financial security for the future. In case of any adverse events, you and your family have your investments to lean back on.

3. **Increases financial awareness:** An investment plan increases your understanding of your current financial situation. It will help you evaluate your financial position and helps you find the best investment product that will suit your situation.

4. **Helps maintain and improve the standard of living:** In times of an emergency, your investments can come in handy. For example, if you lose your job, you can use your investments to pay your bills until you find a new one. Even if there is no emergency, you can use the returns from your investments to fulfil your financial goals, such as buying a car or house.

5. **Manages income and expenditure efficiently:** With an investment plan, you can manage your income and expenditure. For example, you can create a budget which will help in planning your expenditure and savings ahead of time.

4.12 CONCEPT OF RETIREMENT PLANNING

Retirement planning refers to financial strategies of saving, investments, and ultimately distributing money meant to sustain oneself during retirement.

It determines retirement income goals and the actions and decisions necessary to achieve those goals. It includes identifying sources of income, sizing up expenses, implementing a savings program, and managing assets and risk. Future cash flows are estimated to gauge whether the retirement income goal will be achieved. Retirement planning is ideally a lifelong process you can start at any time, but it works best if you factor it into your financial planning from the beginning that is the best way to ensure a safe, secure and fun retirement.

Retirement planning means preparing today for your future life so that you continue to meet all your goals and dreams independently. This includes setting your retirement goals, estimating the amount of money you will need, and investing to grow your retirement savings. Every retirement plan is unique. After all, you may have very specific ideas on how you want to spend your retired life. This is why it is important to have a plan that is designed specifically to suit your individual needs. You have worked hard and built a life for yourself and your family one full of dreams, achievements, and happiness. Now, as you near retirement, you may have new dreams and goals in mind. You may want to spend more quality time with your loved ones or travel the world or also want to fulfil commitments like your child's higher education or wedding.

Understanding Retirement Planning

In the simplest sense, retirement planning is what one does to be prepared for life after paid work ends. This is not just financially but in all aspects of life such as non-financial aspects that includes lifestyle choices such as how to spend time in retirement, where to live, and when to quit working altogether, among other things. A holistic approach to retirement planning considers all these areas. Emphasis that one puts on retirement planning changes at different stages of life. For instance:

- Early in a person's working life, retirement planning is about setting aside enough money for retirement.
- During the middle of your career, it might also include setting specific income or asset targets and taking steps to achieve them.

- Once you reach retirement age, you go from accumulating assets to what planners call the distribution phase. You're no longer paying into your retirement account(s). Instead, your decades of saving begin paying you out.

4.13 IMPORTANCE OF A RETIREMENT PLAN

Now that you understand the meaning of retirement planning, you must have realised that engaging in secure retirement planning is crucial to staying financially secure. A structured retirement annuity plan equips you to handle various factors such as surpluses, shortfalls and emergencies. So ultimately, a thorough retirement plan will let you develop a comprehensive understanding of your life goals and define the path to achieve the same. Here's why you should start preparing early on rather than when it's too late.

- **Stay financially prepared for medical emergencies:** As you grow old, you may need healthcare facilities. A retirement plan can help you cover these expenses without affecting your savings.
- **Stay financially independent:** A retirement plan can help you continue your current lifestyle even after retirement. The income from the plan can help you meet your day- to-day expenses and meet your financial goals post retirement.
- **Help your family as well:** Retirement plans not only help you but also those around you. Income from the plan can enable you to help your loved ones, including child and your spouse, whenever they are in need of money.
- **Meet your financial goals:** Apart from life's necessities, retirement plans can also help you fulfil your goals post retirement. You may have retirement goals, such as travelling, pursuing a hobby, starting a new venture, and more. Retirement plans can help you fulfil these goals without any worry.
- **Fulfil retirement goals:** Retirement takes you to a new phase of your life wherein you can genuinely make time for yourself and indulge in

activities that you have not been able to pay attention to during your work life. These can include picking up on an old hobby, actively working on your kids' future, working on a venture you have been planning for years, etc.

- **Maintain the standard of living:** We all follow a particular lifestyle and with age it gets deeply incorporated into our daily habits. The lifestyle we lead today is because of the income we receive every month. Investing in a retirement plan is necessary to ensure this same standard of living post-retirement. That will help you with a steady income every month even after retiring.
- **Zero burden on family:** After your retirement, you should not depend on anyone, especially your family or relatives. Having a firm plan in your position will ensure that you do not become a financial responsibility for those close to you. You want to be in a place where you are able to help a family member's financial condition, "If needed", not to make things adversarial. If you have planned consciously and kept a healthy amount loaded for retirement, you may have a lovely gift to give your children by adding to their wedding plans or grandchildren for their studies, gifts, etc., when your time comes.

4.14 ADVANTAGES OF RETIREMENT PLANS

Saving enough for your future is a crucial part of your financial plan when you have a stable income source. The retirement planning benefits may not be a primary concern for you as that stage of life seems years away. However, the important thing to note here is that the benefits of retirement planning are more optimum if you start early. Below are the advantages of a retirement plan:

- **Regular income after retirement:** A retirement plan helps you create a regular flow of income after retirement. Retirement plans offer a fixed income which substitutes for your pre-retirement salary. You can use this money to cover your daily expenses, such as groceries, fuel,

electricity, and more. You can also meet your post-retirement goals, such as travelling, pursuing a hobby, starting a new venture, and more.

- **Tax benefits:** A retirement plan provides you with tax2 benefits. You can claim a deduction of up to [1] 1.5 lakh for the premiums paid towards the plan under Section 80C2 of the Income Tax Act, 1961. So, you can save for your future needs as well as lower your taxes.
- **Returns on investment:** Investing in a retirement plan instrument can help you save and grow your money over time depending on your financial profile, you must decide which investment tool is more suitable for you and the returns from such an investment will be better when you plan them at the right time. You can fulfil the financial expectations appropriately by calculating the required savings amount. As a consequence, you can enhance the benefits of retirement planning in terms of the returns.
- **Cost savings:** The cost of retirement planning can be reduced in various ways. When you envision the retirement planning benefits for yourself at a younger age, you can begin investing earlier. Any long-term investment plan is more fruitful when you give it the

required time. Furthermore, a younger and healthier individual can enjoy the benefits of retirement planning at lower premium rates. Whereas, if you invest later in life, it increases related risks and decreases the period of investment, resulting in higher costs.

- **Legacy opportunities:** When you imagine your life goals postretirement, it can look completely different from now as your priorities may go through a transformation with age and time. Among the benefits of retirement planning, the legacy opportunity is one that can cover such possibilities because you can leave behind a large sum of money for your heirs or for a charitable cause that you prefer. Hence, begin planning early for retirement to save as much as you can and assign it as per your wishes in the future.

- **Protection of assets and property:** Retirement may seem like many years down the line, but it may not be as far as you think. If you wait several years before planning for retirement, you may not have enough time to do it well as many people resort to selling their properties and assets to meet life's expenses after retirement. You can eliminate the need for that by preparing an investment plan at a younger age, thereby acquiring the maximum benefits of retirement planning.

4.15 FACTORS TO REMEMBER WHILE PLANNING FOR RETIREMENT

There are so many things that one should keep in mind while planning for the retirement because everyone anticipates the day they can retire and finally say goodbye to the workforce it makes no difference where you are in life. Tax benefits are possible, but they might not be sufficient, mainly if you are used to a particular way of life. Therefore, planning for Retirement becomes essential in this situation.

1. **Psychological Myopia:** You might have all sorts of fires to douse at present, and resources might not seem enough. Problems in the present almost always seem more important than the issues of the future. Until the future problem comes to the present, that is, start investing for Retirement as early as possible. Remember, the sooner you invest, the more you will have at retirement.

2. **Life Expectancy:** You are going to live longer than your grandparents did; that is certain. Improvement in healthcare and lifestyle is going on, extending people's lives worldwide. The longer you live, the more money you will require.

3. **Retirement Age:** The longer you live, the longer you will work. This can prove to help your Retirement investments. More people are opting to push Retirement to a later date, therefore can earn more and for longer. Often, this push is fuelled by their insufficient funds. If done well, Retirement Planning can allow you to quit work much before others.

4. **Rising Healthcare Costs:** The older you get, the more you will have to spend on healthcare. Medicines, tests, treatments, and maybe even a nurse at some point will all go on burdening your wallet as you age.

5. **Calculate Your Investments for Retirement:** It is necessary to calculate your investments strategically while planning for retirement. You can use various tools, including a Retirement Planning Calculator, Medicare Tool, Loan Amortization Tables, etc., to estimate your future expenses and investments.

6. **Earning More, Spending More:** You might be happy flying economy today, but as the years go by and your pay check rises, you might switch to business class. However, if you plan your retirement based on your lifestyle today and in a few years your lifestyle improves, switching back to economy seats after Retirement will sting, especially at an age when you need the comforts of business class more. Even better, if you continue living below your means today, you will have more money to invest and, consequently, even more, money to throw around after retirement.

7. **The Past is No Indication of the Future:** You must plan to save as much for your Retirement as possible. Then, if the rate of inflation remains similar, you will be prepared for it. If the rate of inflation is less, you will have a lot more than you had planned to have after retirement. However, if you are very unlucky and the rate of inflation is more significant than what you planned for, you will have to make compromises in your winter years. How well you insulate yourself from such ugly surprises depends on how much extra you would have saved.

8. **Return on Investment:** If you start investing early in your life, the number of years for the magic of compounding to grow your money will span more than three decades. Even a tiny difference in the rate of return on your investments can have a magnified effect at the time of retirement. So be sure to ascertain your risk-taking ability and opt for the investment adding the most value to your funds.

4.16 SUMMARY

In this lesson you are able to understand various aspects of planning like education planning, investment planning and retirement planning. All these aspects have their own importance in every step of life like education planning is the activity that allows the public authorities to orient educational development and identify priority interventions, sound education planning is critical to ensuring education targets and goals are identified, programs and projects are defined and coordinated and proper allocation of resources is made to ensure goals can be reached. Where possible, development partners should work alongside government and be engaged in the education planning and budgeting processes. The investment planning involves identifying specific financial goals and putting together a strategy for achieving them so as planning for retirement must be a non-negotiable part of everyone's financial strategy. The future may be uncertain, but it can help to be prepared. Diversify your retirement corpus by investing in mutual funds, fixed-income securities, and other government-backed securities. Start as soon as you can so that your later years are relaxed.

4.17 GLOSSARY

- Planning: It is a process that helps administrators to answer certain questions that are relevant to decision making process e.g. What is to be done, where shall it be done or when will it be done, who will do it or how will it be done?
- Retirement: It is the withdrawal from one's position or occupation or from one's active working life. A person may also semi-retire by reducing work hours or workload.
- Investment: It is an asset acquired or invested in to build wealth and save money from the hard earned income or appreciation.

4.18 SELF-ASSESSMENT QUESTIONS

Q1. What are the principles of education planning?

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Q2. Discuss various factors to be remember while planning a retirement.

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Q3. Explain the various techniques of Risk management.

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4.19 SUGGESTED READINGS

- https://www.maxlifeinsurance.com/blog/retirement-planning/benefits-of- retirement-plan
- https://www.kotaklife.com/insurance-guide/retirement/importance-of-retirement-planning
- https://jupiter.money/blog/investment-planning
- Investment and Retirement Planning: A Conceptual Analysis by Anushree Ganguly
- https://www.carboncollective.co/sustainable-investing/investment-plan
- https://www.usca.edu/center-for-student-achievement/student-resources/educational-planning
- Principles Of Education Planning by Harshita Jain, 2023
- https://www.sedgwick.com/blog/2022/03/21/5-basic-principles-of-risk-management

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UNIT-I LESSON NO. 5

FINANCIAL PLANNING

ETHICS AND BUSINESS ASPECTS OF FINANCIAL PLANNING

STRUCTURE

5.1 Introduction

5.2 Objectives

5.3 Meaning of Ethics

5.4 Concept of Ethics in Financial Planning

5.5 Ethical Principles in Financial Planning

5.6 Promoting Ethical Practices in Financial Planning

5.7 Ethical Issues in Financial Planning

5.8 Business aspects of Financial Planning

5.9 Summary

5.10 Glossary

5.11 Self-Assessment Questions

5.12 Suggested Readings

5.1 INTRODUCTION

Ethics is based on well-founded standards of right and wrong that prescribe what humans ought to do, usually in terms of rights, obligations, benefits to

society, fairness, or specific virtues. Failing to do so may result in investment losses and harm the institution's reputation. Conflicts of interest are a significant ethical issue. Financial professionals need to steer clear of circumstances when their own interests conflict with those of their clients. They must ensure that their choices are purely motivated by what is in their clients' best interests by disclosing any potential conflicts of interest. Financial ethics also includes a duty to society as a whole. Financial institutions have a duty to make sure that their investments don't have a negative impact on society or the environment. Business ethics ensure that a certain basic level of trust exists between consumers and various forms of market participants with businesses. For example, a portfolio manager must give the same consideration to the portfolios of family members and small individual investors as they do to wealthier clients. These kinds of practices ensure the public receives fair treatment. They must also follow rules and legislation that support social welfare. Financial planning professionals are placed in positions of trust by clients, and the ultimate source of that trust is the financial planning professional's personal integrity. Allowance can be made for legitimate differences of opinion, but integrity cannot co-exist with deceit or subordination of one's principles. Integrity requires the financial planning professional to observe both the letter and the spirit of the Code of Ethics. The concept of business ethics began in the 1960s as corporations became more aware of a rising consumer-based society that showed concerns regarding the environment, social causes, and corporate responsibility. The increased focus on "social issues" was a hallmark of the decade.

5.2 OBJECTIVES

After reading this lesson, you will be able to understand:

- Meaning of Ethics
- Concept of ethics in financial planning
- Ethical issues in financial planning
- Business aspect of financial planning

5.3 MEANING OF ETHICS

The word Ethics is derived from the Greek word 'ethos' which means character or conduct. Ethics is also called as moral philosophy or philosophical thinking about morality. This morality has been further elaborated as action and behaviour which is concerned with 'good' or 'evil', of particular traditions, groups or individual. Ethics or moral philosophy is a branch of philosophy that involves systematizing, defending, and recommending concepts of right and wrong behaviour. Ethics seeks to resolve questions of human morality by defining concepts such as good and evil, right and wrong, virtue and vice, justice and crime. Ethics is the philosophical study of morality. It is one of the main branches of philosophy which corresponds to the traditional division of philosophy into formal, natural and moral philosophy. It can be turned into a general study of goodness, right action, applied ethics, meta-ethics, moral psychology and metaphysics of moral responsibility. The general study of goodness and right action is the main task of ethics. It has correlatively its substantive question as: how are we rational beings and what moral principles should govern our choice and pursuit?

As a field of intellectual inquiry, moral philosophy is related to the fields of moral psychology, descriptive ethics, and value theory. Being ethical is also not the same as following the law. The law often incorporates ethical standards to which most citizens subscribe but laws, like feelings, can deviate from what is ethical.

Definitions of Ethics

Rushworth Kidder states that "standard definitions of ethics have typically included such phrases as 'the science of the ideal human character' or 'the science of moral duty".

Richard William Paul and Linda Elder define ethics as "a set of concepts and principles that guide us in determining what behaviour helps or harms sentient creatures".

Cambridge Dictionary of Philosophy states that the word "ethics" is

"commonly used interchangeably with 'morality' and sometimes it is used more narrowly to mean the moral principles of a particular tradition, group or individual".

Larry Churchill has written: "Ethics, understood as the capacity to think critically about moral values and direct our actions in terms of such values, is a generic human capacity".

5.4 CONCEPT OF ETHICS IN FINANCIAL PLANNING

The ethics of finance refers to the values and principles that influence financial behaviour and decision-making. It is an essential component of the financial sector because finance is so important to the world economy. To keep investors' confidence and preserve the long-term viability of financial markets, ethical behaviour in finance is crucial. Transparency is one of the main moral issues in finance. Investors must get accurate and concise information from financial institutions regarding the risks and rewards of making investments. Maintaining the integrity and sustainability of financial markets depends on financial ethics. Financial professionals can make sure they are making moral choices that are advantageous to both their clients and society at large by adhering to transparency principles, avoiding conflicts of interest, and encouraging social responsibility. Ethics in financial planning ensures that financial planners and advisors act in the best interest of their clients, which helps clients, achieve their financial goals and maintain trust in the planning process. Upholding ethical standards also contributes to the overall integrity and credibility of the financial planning industry, encouraging individuals to seek professional advice and fostering a positive reputation for ethical financial planners. Today financial planning firms can promote ethics in financial planning by implementing ethical training programs, fostering a culture of ethical behaviour, and monitoring and enforcing compliance with ethical standards. These actions can help ensure that financial planners and advisors consistently adhere to the highest levels of professional conduct and act in the best interest of their clients.

- Ethics play a crucial role in financial planning, guiding financial planners in their interactions with clients and decision-making processes.

- Ethical principles such as honesty, integrity, transparency, confidentiality, competence, and professionalism establish trust and ensure the well-being of clients.
- Financial planners have a fiduciary duty to act in the best interest of their clients, encompassing the duty of care and duty of loyalty.
- Compliance with regulatory and industry standards, such as those established by financial industry regulators and professional organizations, is essential.
- Ethical dilemmas may arise, requiring analysis, consultation, and adherence to ethical principles.
- Unethical behaviour can lead to financial losses for clients, damage trust, and have severe consequences for financial planners and the industry, including legal repercussions, reputational damage, and increased regulation.
- Promoting ethical practices involves implementing training programs, fostering a culture of ethical behaviour, and monitoring compliance with ethical standards.

5.5 ETHICAL PRINCIPLES IN FINANCIAL PLANNING

Ethical principles play a crucial role in financial planning as financial planners are entrusted with managing their clients' finances, which can have a significant impact on their clients' lives. As such, financial planners must uphold ethical standards and ensure that they act in their clients' best interests. Ethical principles such as honesty, integrity, transparency, and confidentiality guide financial planners in their interactions with clients and help them to make decisions that are in their clients' best interests. By adhering to ethical principles, financial planners can establish trust with their clients and build long-term relationships based on mutual respect and understanding. In this way, ethical principles are essential for ensuring that financial planning is conducted with professionalism, accountability, and a commitment to the well-being of clients.

A. **Fiduciary A. Duty:** A fiduciary duty is the legal and ethical responsibility of financial planners and advisors to act in the best interest of their clients. This duty involves two main components: the duty of care and the duty of loyalty.

i. **Duty of Care:** Financial planners must exercise the same level of care, skill, and diligence that a prudent professional would in similar circumstances. This includes gathering relevant information, analyzing data, and providing appropriate recommendations to clients.

ii. **Duty of Loyalty:** Financial planners must put their client's interests above their own and avoid any potential conflicts of interest that may compromise their ability to provide unbiased advice.

B. **Integrity:** Integrity is the foundation of ethical financial planning. Financial planners must be honest and transparent in their dealings with clients, disclosing all relevant information, and avoiding any actions that could be construed as deceitful or manipulative.

C. **Competence:** Competent financial planners possess the necessary knowledge and skills to provide sound advice and make informed decisions on behalf of their clients. This includes staying current with industry developments, seeking continuing education, and pursuing professional development opportunities.

D. **Confidentiality:** Financial planners are responsible for protecting the privacy of their clients' personal and financial information. This involves adhering to applicable privacy laws and regulations, as well as implementing internal safeguards to prevent unauthorized access or disclosure of client data.

E. **Professionalism:** Professionalism in financial planning involves upholding high standards of conduct and treating clients with respect and courtesy. Financial planners should adhere to professional codes of conduct and strive to maintain a positive reputation in the industry.

5.6 PROMOTING ETHICAL PRACTICES IN FINANCIAL PLANNING

Ethics in finance refers to the moral principles that guide the behaviour and decision making of finance professionals. These principles ensure that individuals and institutions act with integrity, fairness, and transparency, prioritizing the interests of clients, investors, and the financial system. Maintaining ethical standards in finance is vital for the financial system's stability and growth. Ethical conduct by finance professionals fosters trust and confidence, promotes investments, and supports economic development. Moreover, adhering to ethical principles mitigates the risk of financial crises, safeguarding individual well-being and the wider economy.

a. **Implementing Ethical Training Programs:** Financial planning firms and professional organizations can promote ethical practices by offering training programs that focus on ethical principles, decision-making processes, and real-life case studies.

b. **Encouraging a Culture of Ethical Behavior:** Fostering a culture of ethical behaviour within financial planning firms involves setting clear expectations for conduct, providing support and resources for ethical decision-making, and recognizing and rewarding ethical behaviour.

c. **Monitoring and Enforcing Compliance with Ethical Standards:** Financial planning firms and professional organizations must regularly monitor and enforce compliance with ethical standards to ensure that financial planners adhere to the highest levels of professional conduct.

5.7 ETHICAL ISSUES IN FINANCIAL PLANNING

Ethical dilemmas arise when financial planners face situations that involve conflicting ethical principles or values. These dilemmas may involve conflicts of interest, potential harm to clients, or challenges to professional integrity. Some of the most common ethical issues in financial planning include:

1. **Conflicts of interest:** Financial planners may have conflicts of interest when they have competing interests or loyalties that may influence their

advice. For example, a financial planner may recommend a financial product that benefits them personally, rather than the client.

2. **Misleading or deceptive conduct:** Financial planners may engage in misleading or deceptive conduct when they provide false or misleading information to clients. This may include making exaggerated claims about the performance of an investment or withholding information that is relevant to the client's decision-making process.

3. **Breaches of confidentiality:** Financial planners have a duty to maintain the confidentiality of client information. Breaches of confidentiality may occur when financial planners share client information with third parties without the client's consent.

4. **Failure to disclose fees and commissions:** Financial planners have a duty to disclose all fees and commissions associated with the financial products they recommend. Failure to disclose fees and commissions may be considered unethical and can result in a loss of trust with clients.

5.9 SUMMARY

In this you are able to understand that ethics plays a crucial role in financial planning, guiding financial planners in their interactions with clients and decision-making processes. Ethical principles such as honesty, integrity, transparency, confidentiality, competence, and professionalism establish trust and ensure the well-being of clients. Financial planners have a fiduciary duty to act in the best interest of their clients, encompassing the duty of care and duty of loyalty. Compliance with regulatory and industry standards, such as those established by financial industry regulators and professional organizations, is essential. Ethical dilemmas may arise, requiring analysis, consultation, and adherence to ethical principles. Ethics in financial planning ensures that financial planners and advisors act in the best interest of their clients, which helps clients achieve their financial goals and maintain trust in the planning process. Upholding ethical standards also contributes to the overall integrity and credibility of the financial planning industry, encouraging individuals to seek professional advice and fostering a positive reputation for ethical financial planners. Unethical behaviour

can lead to financial losses for clients, damage trust, and have severe consequences for financial planners and the industry, including legal repercussions, reputational damage, and increased regulation. Promoting ethical practices involves implementing training programs, fostering a culture of ethical behaviour, and monitoring compliance with ethical standards. Ethics are of concern in financial planning as the profession tries to build clients' trust in an industry where misconduct occurs. Two methods of building trust are to create a code of ethics and enforce a requirement to act in a client's best interest. It is unknown what elements of these codes of ethics are impeded or what types of behaviour occur in financial planning misconduct.

5.9 GLOSSARY

- Ethical Behavior: Ethical behaviour is based on written and unwritten codes of principles and values held in society that reflect beliefs about what is right, what is wrong, what is just, what is unjust, what is good, and what is bad in terms of human behaviour.
- Integrity: It is the practice of being honest and showing a consistent and uncompromising adherence to strong moral and ethical principles and values. In ethics, integrity is regarded as the honesty and truthfulness or earnestness of one's actions.
- Fiduciary Duty: A fiduciary duty is the legal and ethical responsibility of financial planners and advisors to act in the best interest of their clients.
- Confidentiality: It involves a set of rules or a promise usually executed through confidentiality agreements that limits the access or places restrictions on certain types of information.

5.10 SELF-ASSESSMENT QUESTIONS

Q1. What are the principles of education planning?

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Q2. Discuss various factors to be remember while planning a retirement.

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Q3. Explain the various techniques of Risk management.

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5.11 SUGGESTED READINGS

- https://www.scu.edu/ethics/ethics-resources/ethical-decision- making/what-isethics
- https://www.financestrategists.com/financial-advisor/financial- planning/ethics-in-financial-planning
- Promoting Ethical Practices in Financial Planning by International college of financial planning.

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UNIT-II LESSON NO. 6

RISK ANALYSIS AND INSURANCE PLANNING

RISK ANALYSIS AND INSURANCE PLANNING

STRUCTURE

6.1. Introduction

6.2 Objectives

6.3 Risk Management

6.4 Importance of Risk Management

6.5 Risk Management Important in Personal Financial Planning

6.6 Factors to Be Considered While Taking Insurance Decision

6.7 Insurance Decision in Personal Financial Planning

6.8 Summary

6.9 Glossary

6.10 Self-Assessment Questions

6.11 Suggested Reading

6.1 INTRODUCTION

We all face risks in our everyday lives. Risks arise from personal activities and range from those associated with travel through to the ones associated with personal financial decisions. There are considerable risks present in the domestic component of our lives, and these include fire risks in our

homes and financial risks associated with home ownership. Indeed, there are also a whole range of risks associated with domestic and relationship issues. Risk can be defined as the chance of loss or an unfavorable outcome associated with an action. Uncertainty does not know what will happen in the future, the greater the uncertainty, the greater the risk. For an individual, risk management involves optimizing expected returns subject to the risks involved and risk tolerance. Risk is what makes it possible to make a profit. If there was no risk, there would be no return to the ability to successfully manage it. For each decision there is a risk return tradeoff. Anytime there is a possibility of loss (risk), there should be an opportunity for profit. Risk management is the process of identifying, assessing and controlling threats to an organization's capital, earnings and operations. These risks stem from a variety of sources, including financial uncertainties, legal liabilities, technology issues, strategic management errors, accidents and natural disasters. A successful risk management program helps an organization consider the full range of risks it faces. Risk management also examines the relationship between different types of business risks and the cascading impact they could have on an organization's strategic goals. Risk management and insurance play crucial roles in creating a comprehensive financial plan. While we all hope not to face major tragedies – the death of a spouse, an injury that prevents working, or a major health crisis – planning for them helps best protect the interests of the client, their family, and any business interests they may have.

6.2 OBJECTIVES

After reading the lesson, the student will help you to assess:

- Meaning of risk management
- Importance of Risk Management
- Importance of risk management in personal financial planning
- Factors to be considered while taking insurance decision
- Insurance Decision in Personal Financial Planning

6.3 RISK MANAGEMENT

Risk management is the overcoming of risks to the organization that can cause financial uncertainties. Risk management is the process of identifying, assessing and controlling financial, legal, strategic and security risks to an organization's capital and earnings. These threats, or risks, could stem from a wide variety of sources, including financial uncertainty, legal liabilities, strategic management errors, accidents and natural disasters. If an unforeseen event catches your organization unaware, the impact could be minor, such as a small impact on your overhead costs. In a worst-case scenario, though, it could be catastrophic and have serious ramifications, such as a significant financial burden or even the closure of your business. To reduce risk, an organization needs to apply resources to minimize, monitor and control the impact of negative events while maximizing positive events. A consistent, systemic and integrated approach to risk management can help determine how best to identify, manage and mitigate significant risks.

6.4 IMPORTANCE OF RISK MANAGEMENT

Risk management is very important for any organization to proceed with the growth and success of its goals. This management is used to mitigate the risks in the uncertainties of investments. Furthermore, it is the process of analysis and acceptance of the uncertainty in investments. Here are some most important benefits of risk management.

1. Job Security
2. Project Success
3. Financial Benefits
4. Minimize Unexpected Events
5. Save Time and Effort

1. **Job Security :** Job security is the utmost priority of the employees therefore, the risk manager has to find out the problematic areas in the organization and address them. Although the physical workplace environment should be good enough to sustain the employees, however,

it is not that easy to maintain since the risk factors involved. Furthermore, the risk management process uses the analysis of data and resolving the risks and prevents it from happening twice. The use of risk management strategies is very important to create a safer workplace environment. A risk manager's responsibilities include health and safety. They systematically search out and discuss issue areas within the company. So, they use data analysis to spot patterns in failure and injury and devise methods to keep them from happening again. Especially this is beneficial to employees in physically demanding employment. Such as construction, but it can also benefit office workers and those in similar roles through ergonomics. In addition, risk management has a significant effect on making the workplace a safer environment for all.

2. **Project Success :** Project success is the primary goal of all organizations. Therefore, they use strong risk management solutions to overcome the risk factors. In addition, when a company starts working on a project, they make the necessary strategies for controlling the potential project risks to have a successful outcome. The risk management process allows a firm to accomplish its goals by completing the projects. The risk manager assesses the problems and improves organizational growth. Moreover, the strategies involve the methods for reducing the probability and seriousness of the risks earlier. Risk managers may assist workers in completing their tasks, regardless of department. They should evaluate risks and develop strategies for individual projects. Particularly in the same way they assess risks and develop techniques for organizational performance. Therefore, employees can reduce the probability and seriousness of project threats by recognizing them early on. If something goes wrong, there will already be a plan in place to deal with the situation. Thus, employees are more prepared for unpredictable project results as a result of this.

3. **Financial Benefits:** The risk element in an organization cannot be only thought of as financial loss. With the trend analysis, it can create value for the company. Furthermore, with risk management, there are fewer

chances of risks and their occurrence. The risk factor is also minimized which leads to the growth of an organization. A risk management plan most importantly helps to increase the finance of a company. This benefits the organization at a maximum level. The organization's risk department should not be perceived as a cost center. In reality, it generates value directly. So, risk managers may use pattern analysis to identify high-frequency incidents and seek to reduce repeat losses. Incidents would be less likely to happen and have a smaller effect when they do. Moreover, potentially saves the company thousands, if not millions, of dollars. Therefore, risk managers are also the professionals who obtain the required levels of insurance to optimize the risk management program's financial effect.

4. **Minimize Unexpected Events:** Many organizations have a risk management department that controls unexpected risk scenarios. This involves the management of the risks to prevent the working of the firm. They cannot completely prevent it but can use some measures to overcome the maximum impact on the organization. In addition, it is not possible to figure out all the possible risk scenarios but the managers try their best to maintain the consistency of the work. Most people dislike surprises, particularly when they affect their workplace. So, the aim of a risk manager is to map out all future risks and then try to avoid or mitigate them as best as possible. Hence, it's difficult to anticipate and handle every imaginable risk situation. However, a risk manager reduces the likelihood and severity of unexpected surprises.

5. **Save Time and Effort:** Employees at all levels submit the reports of any incident to the risk management department. This reduces their burden of tedious data that enhances their performance in their roles in the organization. Furthermore, the employee can play a part in managing the risks by giving an immediate report to the management department. When accidents occur, employees at all levels spend time reporting data to the risk management department. Since these activities are often carried out in a disjointed and inefficient manner. In addition, the risk

department is able to relieve employees of the burden of tedious data submission by streamlining these tasks. Moreover, allowing them to focus their time and energy on their true roles. Thus, it is simple for workers to buy into high-return risk management programs and encourage risk managers' positions. As well as reap the benefits of a structured risk management program, when a solid mechanism is in place.

6.5 RISK MANAGEMENT IMPORTANT IN PERSONAL FINANCIAL PLANNING

Effective personal finance planning helps individuals weather economic and financial challenges and ensures they don't outlive their money. Through risk management, account holders can improve the long-term sustainability of their savings and investment portfolios by identifying and planning against potential threats to their financial stability. Inadequate risk management could result in limited and less desirable financial options during retirement or the loss of income. In worse cases, account holders may face increased debt and a vicious cycle of high-interest rates. These negative cash flows ultimately compromise a person's quality of life, which worsens with excessive stress levels. With the right amount of risk management in personal finance planning, individuals can make the most of their insurance policies, generating more retirement savings, cushioning against unexpected healthcare expenses, and building a more comfortable inheritance for the next generation.

1. **Assessing the Key Areas in Risk Management :** Risk management involves assessing the diverse risks that abound in the world of finance. Understanding and preparing for these risk factors helps account holders retain control of their financial situation more confidently and consistently. It is crucial to factor in various dimensions of financial preparedness by calculating the potential risks, their probability of occurrence, and the significance of their impact. Recognizing each dimension in wealth and risk management can help account holders effectively safeguard their finances into the future.

2. **Intergenerational Wealth Planning and Dynasty Trusts:** One essential aspect of risk management involves planning the finances for the next generation. While traditional wealth planning focuses on passing finances down from one generation to the next, modern financial models aim to provide families with the opportunity to benefit from combined wealth throughout each member's lifetime. Setting up trusts is a reliable method of providing children with financial stability when they reach a certain age. A trust arrangement takes away the concerns of education and living expenses, giving children a financial head start in adult life, with finances kept safe from creditors.

3. **Estate Planning:** Estate planning is necessary for managing and distributing property rights and other assets in the event of a person's passing or incapacitation. The key processes involved in estate planning include creating a will and/or trust and handling the tax affairs tied to a person's finances. A trusted financial partner can guide account holders through the multiple steps involved in estate planning, such as collecting the required tax and legal documents, reviewing and confirming inheritance planning, and accounting for other components like healthcare proxies (individuals authorized as primary caregivers when an account holder can no longer make certain healthcare decisions).

4. **Emergency Liquidity:** Accessible emergency liquidity helps account holders cushion their finances against unprecedented events such as pandemics and financial crises. Risk management professionals can help determine the projected minimum amount of emergency funds an individual needs to sustain themselves across a given period. A risk management professional can help account holders maintain a healthy emergency plan through regular contributions and budgeting based on closely monitored financial patterns.

6.6 FACTORS TO BE CONSIDERED WHILE TAKING INSURANCE DECISION

An insurance is a legal agreement between an insurer (insurance

company) and an insured (individual), in which an insured receives financial protection from an insurer for the losses he may suffer under specific circumstances. Under, an insurance policy, the insured needs to pay regular amount of premiums to the insurer. The insurer pays a predetermined sum assured to the insured if an unfortunate event occurs, such as death of the life insured, or damage to the insured or his property. The literal meaning of insurance would be an assurance against unforeseen and unfortunate loss. This means, that if you encounter a less than normal event in your normal course of life, and happen to incur a financial loss because of it, you can be compensated. For example, you met with an accident on your way to the office in your car and the car suffers damage. Your insurer can reimburse the repair expenses in this case. However, the insurer will not reimburse normal wear and tear like a headlamp stopped working. Legally insurance has been defined as a contract where the insurer agrees to compensate the insured against the losses incurred due to any unforeseen contingency. The contract also involves a consideration which is called a premium. The maximum available benefit amount is called sum assured or sum insured. There are many occasions in life when you wonder if you have taken the right decision. Some of the decisions may concern your financial life. Investing your hard-earned money in any financial product of a company or a bank - recommended by your friends, family or agent - without understanding how it works, is a common issue. Your mind is filled with doubts and uncertainty on whether you have made the right investment, especially if it is in a long-term product like insurance. An insurance policy is a must in any financial portfolio as it covers the risk associated with the loss of life or property. Since it's a long-term contract for 10 years or more, it is difficult to make changes or amend these contracts during the policy term. Hence, you must spend a little time to research these products to ensure you don't have regrets later. It may not be possible for you to understand all the intricacies of a life insurance policy. But, you could consider the following factors while choosing a plan:

i. **Need-based investment:** The standard thumb rule is that your life cover should be 10 times your annual income so that your family is not

impacted financially in case something were to happen to you. You should also take into account any pre-existing medical complication or property loans while selecting the life cover. Your financial portfolio should be well balanced and need-based. For example, in case you need to build a corpus for your child's education, you can select from a range of products from insurance companies that ensure the funds that you had planned for your child's education are available whether you are around or not. You need to remember that insurance is a protection-cum-long-term investment and savings tool. You need to define your need - like your child's education or retirement - and accordingly buy a policy that will help you meet your requirement in future.

ii. **Background check and due diligence:** Once you have decided on the policy, you could do the necessary background check on the company concerned. All life insurance companies have comprehensive disclosures on their websites that give all required information. Policy structure, customer service capabilities, scope of network, online platform (in case someone wants to buy online term policy), are some of the key things you should look for. Secondly, there are many sites that help you compare various policies as well as the premiums. However, the one thing you need not worry is the financial health of an insurance company. The insurance sector is highly regulated and all companies need to maintain a solvency ratio to ensure that the customer does not suffer.

iii. **Fund performance:** When buying a ULIP, which also acts as an investment vehicle, you could look at the past performance of the company. All life insurance companies provide details of their funds' performance online. An important thing to consider here would be stability. A company with a good fund performance will have a consistent track record with the fund performance neither being erratic nor extremely risky.

iv. **Claim settlement ratio:** Many experts advise that the claim settlement ratio of an insurance company should also be considered when buying a

product. However, this should not be of concern as long as you have provided correct information in your policy form. As mentioned earlier, the insurance sector is highly regulated. Hence, the chances of a rightful claim not being settled is rare.

v. **Understanding the policy:** Once you have zeroed in on the product based on your need and track record of a company, you should understand the features of the policy, specifically those related to the policy term, premium-paying term, maturity date and charges. You must also understand the benefit structure of the policy.

6.7 INSURANCE DECISION IN PERSONAL FINANCIAL PLANNING

We have several financial goals at different life stages and come across various unexpected events that require us to prioritise the well-being and security of our loved ones. Accordingly, it is crucial to have a solid financial plan that could help attain financial stability and ensure a brighter future for them. While people often create solid financial plans by setting their goals and investing across diverse asset classes, many of them fail to recognise the importance of including insurance in their personal finance strategy. Insurance serves as a critical tool to shield you and your family from unforeseen circumstances and provide financial security when needed. Different insurance policies, such as Health Insurance, Life Insurance, Car Insurance, Home Insurance, and Liability Insurance, cater to diverse needs and situations. Incorporating insurance into your financial planning helps mitigate risks, protect your assets and loved ones, and achieve long-term financial goals with peace of mind. This article will delve into the significance of insurance planning in personal finance and why it is a vital component of any financial strategy.

1. **Provides Coverage Against Risks:** Insurance functions as a tool for managing risk by preparing you for potential financial losses resulting from unforeseen events such as hospitalisation, accident, death, etc. It essentially helps to mitigate the financial impact of such events.

2. **Provides Financial Security:** Insurance policies offer financial security by compensating for any loss that may occur during an emergency. Knowing that an insurance policy will cover such losses can provide a sense of security. This can enable you to plan your finances and accumulate funds towards your goals without worrying about potential emergencies. Furthermore, having insurance in place ensures that unforeseen circumstances do not deplete your planned funds and remain secure for their intended purpose.

3. **Provides Tax Benefits:** Life Insurance and Health Insurance Plans also provide tax-saving benefits. Premiums for Life Insurance Plans are eligible for deductions Therefore, by investing in Insurance Plans, you can also plan your taxes and receive tax benefits.

4. **Provides Peace of Mind: :** Insurance Plans provide a sense of security and peace of mind, as you can rest assured that your savings will not be jeopardised in an emergency, helping promote financial independence for you and your family.

6.8 SUMMARY

Risk management is the overcoming of risks to the organization that can cause financial uncertainties. Risk management is the process of identifying, assessing and controlling financial, legal, strategic and security risks to an organization's capital and earnings. These threats, or risks, could stem from a wide variety of sources, including financial uncertainty, legal liabilities, strategic management errors, accidents and natural disasters. If an unforeseen event catches your organization unaware, the impact could be minor, such as a small impact on your overhead costs. In a worst-case scenario, though, it could be catastrophic and have serious ramifications, such as a significant financial burden or even the closure of your business. To reduce risk, an organization needs to apply resources to minimize, monitor and control the impact of negative events while maximizing positive events. A consistent, systemic and integrated approach to risk management can help determine how best to identify, manage and mitigate significant risks.

6.9 GLOSSARY

- **Risk management:** Risk management is the overcoming of risks to the organization that can cause financial uncertainties.
- **Legally insurance**: Legally insurance has been defined as a contract where the insurer agrees to compensate the insured against the losses incurred due to any unforeseen contingency.
- **Premium:** The contract also involves a consideration which is called a premium.
- **Sum assured or Sum insured:** The maximum available benefit amount is called sum assured or sum insured.

6.10 SELF-ASSESSMENT QUESTIONS

1. What do you understand by risk management? Explain the importance of risk management in general.

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2. Explain the importance of Insurance decisions in personal financial planning.

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3. Critically evaluate the importance of risk management in personal financial planning.

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6.11 SUGGESTED READING

- Financial planning by M. Sinha
- Investment Planning, Tax Planning and Estate Planning by Indian Institute of Banking and Finance
- Direct Taxes Law and Practice by V.K. Singhania & K. Singhania.

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UNIT-II **LESSON NO. 7**

RISK ANALYSIS AND INSURANCE PLANNING

RISK MANAGEMENT APPROACHES AND METHODS

STRUCTURE

7.1 Introduction

7.2 Objectives

7.3 Identifying Client's Exposure to Mortality, Health Disability, Property, Liability and Long-term Care Risk

7.4 Risk Management Approaches and Methods

7.5 Selecting the Appropriate Risk Management Technique

7.6 Insurance Pricing

7.7 Summary

7.8 Glossary

7.9 Self Assessment Questions

7.10 Suggested Reading

7.1 INTRODUCTION

A mortality table, also known as a life table or actuarial table, shows the rate of deaths occurring in a defined population during a selected time interval, or survival rates from birth to death. A mortality table typically shows the general probability of a person's death before their next birthday, based on their current age. These tables are typically used in order to inform the

construction of insurance policies and other forms of liability management. "People with disabilities" sometimes refers to a single population, this is actually a diverse group of people with a wide range of needs. Two people with the same type of disability can be affected in very different ways. Some disabilities may be hidden or not easy to see. According to the World Health Organization, disability has three dimensions:

1. **Impairment** in a person's body structure or function, or mental functioning; examples of impairments include loss of a limb, loss of vision or memory loss.
2. **Activity limitation**, such as difficulty seeing, hearing, walking, or problem solving.
3. **Participation restrictions** in normal daily activities, such as working, engaging in social and recreational activities, and obtaining health care and preventive services.

7.2 OBJECTIVES

After reading the lesson, the student will help you to assess:

- Identifying Client's Exposure to Mortality, Health Disability, Property, Liability and Long term Care Risk
- Risk Management Approaches and Methods
- Selecting the Appropriate Risk Management Technique
- Insurance Pricing

7.3 IDENTIFYING CLIENT'S EXPOSURE TO MORTALITY, HEALTH DISABILITY, PROPERTY, LIABILITY AND LONG-TERM CARE RISK

i. **Identifying Client's Exposure to Mortality**: A mortality table, also known as a life table or actuarial table, shows the rate of deaths occurring in a defined population during a selected time interval, or survival rates from birth to death. A mortality table typically shows the general

probability of a person's death before their next birthday, based on their current age. These tables are typically used in order to inform the construction of insurance policies and other forms of liability management.

ii. **Health Disability: "**People with disabilities" sometimes refers to a single population, this is actually a diverse group of people with a wide range of needs. Two people with the same type of disability can be affected in very different ways. Some disabilities may be hidden or not easy to see. According to the World Health Organization, disability has three dimensions:

1. **Impairment** in a person's body structure or function, or mental functioning; examples of impairments include loss of a limb, loss of vision or memory loss.
2. **Activity limitation**, such as difficulty seeing, hearing, walking, or problem solving.
3. **Participation restrictions** in normal daily activities, such as working, engaging in social and recreational activities, and obtaining health care and preventive services.

Disability can be:

- Related to conditions that are present at birth and may affect functions later in life, including cognition (memory, learning, and understanding), mobility (moving around in the environment), vision, hearing, behavior, and other areas. These conditions may be
  - Disorders in single genes (for example, Duchenne muscular dystrophy);
  - Disorders of chromosomes (for example, Down syndrome); and
  - The result of the mother's exposure during pregnancy to infections (for example, rubella) or substances, such as alcohol or cigarettes.
  - Associated with developmental conditions that become apparent

during childhood (for example, autism spectrum disorder and attention-deficit/hyperactivity disorder or ADHD)

- Related to an injury (for example, traumatic brain injury or spinal cord injuryexternal icon).
- Associated with a longstanding condition (for example, diabetes), which can cause a disability such as vision loss, nerve damage, or limb loss.
- Progressive (for example, muscular dystrophy), static (for example, limb loss), or intermittent (for example, some forms of multiple sclerosisexternal icon).

iii. Property, Liability and LongTerm Care Risk: Property risk is the most common type of physical risk. Think fires or explosions. To manage building risk, and the risk to employees, it is important that organizations do the following:

- Make sure all employees know the location of all exits.
- Install fire alarms and smoke detectors.
- Install a sprinkler system to provide additional protection to the physical plant, equipment, documents and, of course, personnel.
- Inform all employees that in the event of emergency their personal safety takes priority over everything else. Employees should be instructed to leave the building and abandon all work-associated documents, equipment and/or products.

Long-term care (**LTC**) risk is a variety of services which help meet both the medical and non- medical needs of people with a chronic illness or disability who cannot care for themselves for long periods. Long-term care is focused on individualized and coordinated services that promote independence, maximize patients' quality of life, and meet patients' needs over a period of time.

7.4 RISK MANAGEMENT APPROACHES AND METHODS

If you are a business leader, then you already know the importance of risk control. It is imperative that your business has a formal policy to limit the

loss of assets and income. Here are the6 techniques associated with risk management.

i) **Avoidance :** Avoidance is the best means of loss control. This is because, as the name implies, you are avoiding the risk completely. If your efforts at avoiding the loss have been successful, then there is a 0% probability that you will suffer a loss. This is why avoidance is generally the first of the risk management techniques that is considered. It is a means of completely eliminating a threat.

ii) **Loss Prevention :** Loss prevention is a technique that limits, rather than eliminates, loss instead of avoiding a risk completely, this technique accepts a risk but attempts to minimize the loss as a result of it. For example, storing inventory in a warehouse means that it is susceptible to theft. However, since there really is no way to avoid it, a loss prevention program is put in place to minimize the loss. This program can include patrolling security guards, video cameras, and secured storage facilities.

iii) **Loss Reduction** Loss reduction is a technique that not only accepts risks, but accepts the fact that loss might occur as a result of the risk. This technique will seek to minimize the loss in the event of some type of threat. For example, a company might need to store flammable material in a warehouse. Company management realizes that this is a necessary risk and decides to install state-of-the-art water sprinklers in the warehouse. If a fire occurs, the amount of loss will be minimized.

iv) **Separation :** Separation is a risk management technique that involves dispersing key assets. This ensures that if something catastrophic occurs at one location, the impact to the business is limited to the assets only at that location. On the other hand, if all assets were at that location, then the business would face a much more serious challenge. An example of this is when a company utilizes a geographically diversified workforce.

v) **Duplication :** Duplication is a risk management technique that essentially involves the creation of a backup plan. This is often necessary

with technology. A failure with an information systems server should not bring the whole business to a halt. Instead, a backup or failover server should be really available for access in the event that the primary serve fails. Another example of duplication as a risk management technique is when a company makes use of disaster recovery service.

vi) **Diversification :** Diversification is a risk management technique that allocates business resources to create multiple lines of business that offer a variety of products and / or services in different industries. With diversification, a significant revenue loss from one line of business will not cause irreparable harm to the company's bottom line. Risk management is a key component in any sound company strategy. It is necessary to ensure long term organization sustainability and profitability.

7.5 SELECTING THE APPROPRIATE RISK MANAGEMENT TECHNIQUE

The following factors should be considered in the selection of a risk management techniques

i) **Cost:** The cost of employing, as well as the cost of purchasing, a method must be considered. Time spent in gathering the security data, and time spent in making complex estimates (for example, financial estimates of security data which is difficult to quantify financially), contribute to the cost of using a method. The provision of qualitative as well as quantitative techniques provides the flexibility to lower these costs.

ii) **External influences:** The selected method may require the approval of external parties, such as the government or other authorities.

iii) **Organisational structure:** Modern, adaptive organisations may require fast, inexpensive methods whereas more traditional organisations may prefer a well-documented, comprehensive method with more time-consuming, yet more rigorous techniques.

iv) **Adaptability:** A method must be able to adapt to an organisation's needs.

The method must be able to implement existing security policies. Portability and modifiability of the method are required. The method should also be able to be applied to a variety of types of systems. The method should allow the trying out of different combinations of safeguards. The method should enable gathered and analysed security data to be stored and reused in future risk assessments.

vi) **Complexity:** The complexity of a method should be limited such that the method is within the grasp of both managers and security analysts. Simple and precise recommendations should be given to managers at the end of the risk assessment.

vii) **Completeness:** A risk assessment method must consider all aspects of a system's information security (information technology completeness, information security completeness and risk approach completeness.

viii) **Level of risk:** The level of risk of the organisation and its systems can influence the choice of method. A high risk organisation typically needs a more rigorous method than a low risk organisation. Qualitative methods enable major problem areas to be identified quickly and cheaply, making them well-suited to low-medium risk systems.

ix) **Organisational size:** The size of an organisation needs to be considered, as the larger an organisation, the greater the resources it has to spend on purchase or use of a method. In addition, a large organisation may require a method to be more adaptable, for use with a variety of information systems.

x) **Organisational security philosophy**: Different organisations may place an emphasis on particular aspects of information security, reflecting a particular philosophy. For example, military organisations rank confidentiality above integrity.

xi) **Consistency:** This factor includes the reliability of the results, regardless of the method of estimation of the security input data required by the method. The method should produce the same results, irrespective of

the analysts who apply it. The techniques for gathering security data play a significant role in the consistency of the method.

xii) **Useability:** The method should be understandable, easy to use, simple, and capable of handling errors. It should be useable by the available security analysts (who may be untrained in the particular method). The method must be understandable not only by the analysts, but also by managers.

xiii) **Feasibility:** The method should be feasible in terms of its availability, practicality and scope. Note that the compatibility of the risk assessment method with existing systems development methods and CASE tools affects the practicality of the method. The availability and practicality of a method are related to its cost, in terms of time and effort spent, and its purchase cost; the overall cost must obviously be acceptable and justifiable, in order for a method to be considered feasible.

xiv) **Validity:** The method should produce valid results, with recommendations for safeguards which, in practical terms, are implementable. Validity is composed of relevancy, scope and practicality.

xv) **Credibility:** The results of the method must be acceptable to security analysts and to management. They must believe the method to be intuitively credible, and reliable [9]. The credibility of a method is enhanced if the security analysts are confident that the method is complete, if the results of the method can be proven to be correct, and if the method does not rely on simplistic, subjective estimates and calculations of security data. The credibility of the underlying risk model contributes strongly to the overall credibility of the method.

xvi) **Automation:** Automation support within a method should be considered, and should be at a level acceptable to management and security analysts. Automated methods are faster, however the associated loss of human intuition and creativity may led to less economical and less efficient safeguards being selected.

7.6 INSURANCE PRICING

Any company aims to set prices to maximize its profits. This is also referred to as optimal pricing. It is not different in the insurance sector. Ideal pricing (or premium in insurance terminology) must cover:

- Variable costs
- Operating expenses
- Profits

Setting an optimal price depends on understanding costs, price elasticities, consumer preferences, and the strategic actions of competitors. Rate making, or insurance pricing, is the determination of rates charged by insurance companies. The benefit of rate making is to ensure insurance companies are setting fair and adequate premiums given the competitive nature.

7.7 SUMMARY

A mortality table, also known as a life table or actuarial table, shows the rate of deaths occurring in a defined population during a selected time interval, or survival rates from birth to death. A mortality table typically shows the general probability of a person's death before their next birthday, based on their current age. These tables are typically used in order to inform the construction of insurance policies and other forms of liability management. "People with disabilities" sometimes refers to a single population, this is actually a diverse group of people with a wide range of needs. Two people with the same type of disability can be affected in very different ways. Some disabilities may be hidden or not easy to see.

7.8 GLOSSARY

- **Mortality table:** Mortality table, also known as a life table or actuarial table, shows the rate of deaths occurring in a defined population during a selected time interval, or survival rates from birth to death.
- **Long-term care (LTC)**: Long-term care (LTC) risk is a variety of services which help meet both the medical and non-medical needs of

people with a chronic illness or disability who cannot care for themselves for long periods.

- **People With Disabilities: “**People with disabilities” sometimes refers to a single population, this is actually a diverse group of people with a wide range of needs.

7.9 SELF-ASSESSMENT QUESTIONS

1. Explain identifying Client’s Exposure to Mortality, Health Disability, Property, Liability and Long-term care risk.

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2. Discuss the various risk management approaches and methods?

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3. What factors to be considered while selecting the appropriate risk management technique?

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7.10 SUGGESTED READING

- Management and Financial Institutions by John C. Hull.
- Financial planning by M. Sinha
- Investment Planning, Tax Planning and Estate Planning by Indian Institute of Banking and Finance
- Direct Taxes Law and Practice by V.K. Singhania & K. Singhania.

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UNIT-II **LESSON NO. 8**

RISK ANALYSIS AND INSURANCE PLANNING

INSURANCE STRATEGIES, GENERAL INSURANCE

STRUCTURE

8.1 Introduction

8.2 Objectives

8.3 Insurance Policy Contract

8.4 Policy Structure or key elements

8.5 Rules of Interpretation of a Policy

8.6 Insurance Policies and Strategies

8.7 General Insurance

8.8 Summary

8.9 Glossary

8.10 Self-Assessment Questions

8.11 Suggested Reading

8.0 INTRODUCTION

An insurance policy is like any contract, a legal document and enforceable in a court; the provisions of the Indian Contracts Act, 1872 are applicable to insurance contracts as well. The essentials elements of a valid contract of insurance would be. Offer and acceptance ii. Capacity to contract

iii. Consideration iv. Legality of object An offer, intended to create legal relations, must be communicated to the offeree either by words or by conduct. The phrase 'insurance is the subject matter of solicitation' is very commonly seen and heard - what this indicates is that insurance is to be sought by the person who wants to buy it from the insurer. It is advisory in nature. It should not be forced. Customer must not be threatened or coerced to buy insurance. It is to be solicited or purchased by the consumer. It must be remembered that "Customer's participation in availing the insurance products and services are purely on voluntary basis. This means that the insurance company is providing you insurance against a risk on your request/solicitation, i.e. the company has agreed to sell you its insurance policy after you solicited or asked for such a sale. In legal terms, insurance is a product that should not be pushed or sold by a seller, but should be pulled or bought by a buyer.

8.2 OBJECTIVES

After reading the lesson, the student will help you to assess:

- Meaning of Insurance Policy Contract
- Policy Structure of Insurance Policy
- Insurance Policies and strategies
- General Insurance

8.3 INSURANCE POLICY CONTRACT

An insurance policy is like any contract, a legal document and enforceable in a court; the provisions of the Indian Contracts Act, 1872 are applicable to insurance contracts as well. The essentials elements of a valid contract of insurance would be. Offer and acceptance ii. Capacity to contract iii. Consideration iv. Legality of object.

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insurer. It is advisory in nature. It should not be forced. Customer must not be threatened or coerced to buy insurance. It is to be solicited or purchased by the consumer. It must be remembered that "Customer's participation in availing the insurance products and services are purely on voluntary basis. This means that the insurance company is providing you insurance against a risk on your request/solicitation, i.e. the company has agreed to sell you its insurance policy after you solicited or asked for such a sale. In legal terms, insurance is a product that should not be pushed or sold by a seller, but should be pulled or bought by a buyer. The proposal is made by the insured and accepted by the insurer. 1. Agreement between the Parties – The acceptance of the proposal by the insurer together with the premium is expressed in the form of a contract – the insurance policy; together with the clauses is the basis of the agreement between the parties. 2. There must be Evidence of the Intention of the parties to enter into a contractual relation. This may be provided by the formal procedure of making the promise under seal, or it may be by the existence of consideration. 3. Consideration –The premium paid by the insured for the contract is the consideration 4. The parties must be recognized by the law as having the Capacity to Contract.

All aspects regarding the capacity to contract, age, mental capacity and understanding etc. as defined in the Indian Contracts Act, 1872 is applicable. 5. The consent of the parties MUST BE REAL; that is to say, the parties must not have been threatened, unduly influenced, deceived or misled in a manner which would nullify their agreement. 6. The subject-matter of the contract must be Legal and Possible. If one of these essentials is missing, the contract is void, voidable or unenforceable, depending upon the circumstances. A void "contract" is a contradiction in terms for it never can be a contract. A voidable contract is valid but, at the option of one of the parties.

8.4 POLICY STRUCTURE OR KEY ELEMENTS

i. **Heading**: The name of the insurer and other particulars regarding the issuing office- the name of the policy etc.

ii. **Preamble:** This contains relevant information regarding the subject matter of insurance, the locations, identity, value, and period of insurance required etc.

iii. **Signature:** The signature of an authorized official empower to accept the offer of the proposer and issue a policy.

iv. **Operative or insuring clause** - States the peril(s) which are to be insured against.

v. **Exclusions**: States the various conditions under which the policy will not pay.

8.5 RULES OF INTERPRETATION OF A POLICY

Like any other contract, disputes do arise regarding liability, quantum, extent and duration of cover, especially in cases where the insurer may have earlier repudiated the claim. It follows therefore, that interpretation of the policy document, is of paramount importance even at the time of inception and during the currency of the policy and not only in a court of law. The policy document being a standard document, drafted by the insurer, the benefit of doubt is always in favour of the insured, as a principle of natural justice. This is as per the contra preferen tum rule which states that where the contractual language is capable of alternative interpretations, it will be construed or translated in favour of the insured, who accepts the standard contract. Briefly, the following rules are applied-

- Printed and written portion of the policy is to be construed together as far as possible.
- In case of contradiction, the written portion over-rides the printed portion.
- The policy is to be interpreted as a whole.
- The words in the policy are to be given their plain, ordinary and popular meaning.
- Technical words are to be given their strict technical meaning.
- The ordinary rules of grammar shall apply

8.6 INSURANCE POLICIES AND STRATEGIES

In insurance, the insurance policy is a contract (generally a standard form contract) between the insurer and the policyholder, which determines the claims which the insurer is legally required to pay. In exchange for an initial payment, known as the premium, the insurer promises to pay for loss caused by perils covered under the policy language. Insurance contracts are designed to meet specific needs and thus have many features not found in many other types of contracts. Since insurance policies are standard forms, they feature boilerplate language which is similar across a wide variety of different types of insurance policies. The insurance policy is generally an integrated contract, meaning that it includes all forms associated with the agreement between the insured and insurer. In some cases, however, supplementary writings such as letters sent after the final agreement can make the insurance policy a non-integrated contract. Insurance strategies can vary depending on your specific needs and goals. Here are a few common insurance strategies:

i. **Risk Assessment:** Start by assessing your personal and financial risks. Identify the areas where you need protection, such as health, life, property, or liability.

ii. **Diversify Coverage:** Consider a mix of insurance policies to cover different risks. This may include health insurance, life insurance, auto insurance, home insurance, and liability insurance.

iii. **Emergency Fund:** Build an emergency fund to cover small to moderate unexpected expenses. This can help you avoid making small claims on your insurance, which can raise your premiums.

iv. **High Deductibles:** Opt for higher deductibles on insurance policies like auto or home insurance. This can lower your premiums but means you'll pay more out of pocket if you make a claim.

v. **Bundling:** Some insurers offer discounts for bundling multiple policies with them. Combining auto and home insurance with the same company, for example, can save you money.

vi. **Regular Review:** Periodically review your insurance policies to ensure they still meet your needs. As life circumstances change, your insurance requirements may also change.

vii. **Health Savings Account (HSA):** Consider an HSA if you have a high-deductible health plan. It allows you to save money for medical expenses tax-free.

viii. **Life Insurance:** Determine the right type and amount of life insurance based on your family's financial needs. Term life insurance is often a cost-effective choice.

ix. **Long-Term Care Insurance:** If you're concerned about covering future nursing home or in-home care expenses, consider long-term care insurance.

x. **Disability Insurance:** Protect your income with disability insurance. It provides income if you're unable to work due to an injury or illness.

xi. **Annuities:** Consider annuities for retirement income. They can provide a steady stream of payments after you retire.

xii. **Professional Advice:** Consult with an insurance professional or financial advisor to help tailor your insurance strategies to your specific situation.

xiii. **Umbrella Insurance:** This provides an extra layer of liability protection beyond your standard home and auto insurance. It's useful if you have substantial assets to protect.

xiv. **Rider Policies:** Consider adding rider policies to your existing insurance. For example, you can add earthquake coverage to your homeowners' insurance if you live in a seismic- prone area.

xv. **Self-Insurance:** For some risks, you may choose to self-insure. This means setting aside money to cover potential losses instead of paying premiums. This can make sense for low- cost items or when you have a strong financial cushion.

xvi. **Shop Around:** Don't settle for the first insurance quote you receive. Shop around to find the best coverage at the most competitive rates.

xvii. **Maintain a Good Credit Score:** Your credit score can affect your insurance rates. Maintaining a good credit score can lead to lower premiums.

xviii. **Take Advantage of Discounts:** Many insurers offer discounts for various factors, such as safe driving, security systems for your home, or a good health record. Make sure to ask about available discounts.

xix. **Mitigate Risks:** Implement safety measures to reduce risks. For example, installing smoke detectors, a security system, or driving safely can lead to lower insurance premiums.

xx **Assess Your Vehicle:** If you own a car, the type of vehicle you drive can impact your insurance costs. Safety features and the car's age can affect premiums.

xxi. **Consider Short-Term Policies:** If you only need insurance for a limited time, such as when renting a car or during a short trip, consider short-term policies to save money.

Always keep in mind that insurance strategies should align with your financial goals and risk tolerance. Balancing the right amount of coverage with affordability is key to making insurance work for you. Insurance is a tool to manage risk, and the right strategy depends on your individual circumstances and goals. Always read and understand your policy terms, and regularly reassess your coverage as your life changes.

8.7 GENERAL INSURANCE

A popular or generally accepted idea is that all insurance other than life is non - life or general insurance. General Insurance comprises of insurance of property against fire, burglary and natural calamities like floods and earthquakes etc., personal insurance such as Accident and Health Insurance, and liability insurance which covers legal liabilities. There are also other covers such as Errors and Omissions insurance for professionals, credit insurance, agricultural insurance, etc. Non-life insurance companies have products that cover property against fire and allied perils, flood storm and inundation, earthquake and so

on. The non-life insurers offer policies covering machinery against breakdown, there are policies that cover the hull of ships and so on. A marine cargo policy covers goods in transit including by sea, air and road. Further, insurance of motor vehicles against damages and theft forms a major chunk of non-life insurance business. In respect of insurance of property, it is important that the cover is taken for the actual value of the property to avoid being imposed a penalty should there be a claim. Personal insurance covers include policies for Accident, Health etc. Products offering Personal Accident cover are benefit policies. Health insurance covers offered by non-life insurers are mainly hospitalization covers either on reimbursement or cashless basis. The cashless service is offered through Third Party Administrators who have arrangements with various service providers, i.e., hospitals. The Third Party Administrators also provide service for reimbursement claims. Sometimes the insurers themselves process reimbursement claims. Accident and health insurance policies are available for individuals as well as groups. A group could be a group of employees of an organization or holders of credit cards or deposit holders in a bank etc. Normally when a group is covered, insurers offer group discounts. Liability insurance covers such as Motor Third Party Liability Insurance, Workmen's Compensation Policy, etc., offer cover against legal liabilities that may arise under the respective statutes— Motor Vehicles Act, The Workmen's Compensation Act, etc. Some of the covers such as the foregoing (Motor Third Party and Workmen's Compensation Policy) are compulsory by statute. Liability Insurance not compulsory by statute is also gaining popularity these days. Many industries insure against Public liability. There are liability covers available for Products as well. There are general insurance products that are in the nature of package policies offering a combination of the covers mentioned above. For instance, there are package policies available for householders, shop keepers and also for professionals such as doctors, chartered accountants etc. Apart from offering standard covers, insurers also offer customized or tailor-made ones. Industries also need to protect themselves by obtaining insurance covers to protect their building, machinery, stocks, etc. and need to cover their liabilities as well. Financiers insist on insurance of property which they finance through loans. So, most industries or

businesses that are financed by banks and other institutions do obtain covers. Most general insurance covers are annual contracts. However, there are few products that are long-term. It is important for proposers to read and understand the terms and conditions of a policy before they enter into an insurance contract. The proposal form needs be filled correctly and completely, as this is the offer and first step of the insurance contract; it is always filled by a proposer to ensure that the cover is adequate and the right one. Unlike Life insurance, General insurance contracts are based on indemnity of the loss incurred by the insured. Therefore, the losses will have to be measured accurately. Insurance business is one of the most highly regulated businesses globally for reasons of equity and efficiency. It has a well-defined regulatory and legislative framework to operate. Insurance law by itself is both unique and comprehensive because it operates within the limitations of all the other governing legislations and ensures the legal provisions by incorporating the same in its various policies. The transactions of general insurance business in India are governed by two main statues, namely:

- The Insurance Act, 1938
- General Insurance Business (Nationalisation) Act, 1972

The Insurance Act was passed in 1938 and was brought into force from 1st July, 1939. This act applies to the GIC and the four subsidiaries. The act was amended several times in the years 1950, 1968, 1988, 1999. This Act specifies the restrictions and limitations applicable as specified by the Central Government under powers conferred by section 35 of the General Insurance Business (Nationalization) Act, 1972. The important provisions of the Act relate to: Registration: Every insurer is required to obtain a Certificate of Registration from the Controller of Insurance, by making the payment of requisite fees. Registration should be renewed annually. Accounts and audit: An insurer is required to maintain separate accounts of the receipts and payments in each class of insurance viz. Fire. Marine and Miscellaneous Insurance. Apart from the regular financial statements, the companies are required to maintain the following documents in respect of each class of insurance:

- Record of Cover notes specifying the details of the risk covered
- Record of policies
- Record of premiums
- Record of endorsements
- Record of Bank guarantees
- Record of claims
- Register of agency force and business procured by each with details of commission
- Register of employees
- Cash Books
- Reinsurance details
- Claims register

Investments: Investments of insurance company are usually made in approved investments under the provisions of the Act. The guidelines and limitations are issued by the Central Government from time to time.

Limitation on management expenses: The Act prescribes the maximum limits of expenses of management including commission that may be incurred by an insurer. The percentages are prescribed in relation to the total gross direct business written by the insurer in India.

Prohibition of Rebates: The Act prohibits any person from offering any rebate of commission or a rebate of premium to any person to take insurance.

8.8 SUMMARY

In insurance, the insurance policy is a contract (generally a standard form contract) between the insurer and the policyholder, which determines the claims which the insurer is legally required to pay. In exchange for an initial payment, known as the premium, the insurer promises to pay for loss caused by perils covered under the policy language. Insurance contracts are designed

to meet specific needs and thus have many features not found in many other types of contracts. Since insurance policies are standard forms, they feature boilerplate language which is similar across a wide variety of different types of insurance policies. The insurance policy is generally an integrated contract, meaning that it includes all forms associated with the agreement between the insured and insurer. In some cases, however, supplementary writings such as letters sent after the final agreement can make the insurance policy a non-integrated contract. Insurance strategies can vary depending on your specific needs and goals.

8.9 GLOSSARY

- **Insurance policy :** The Insurance policy is a contract (generally a standard form contract) between the insurer and the policyholder, which determines the claims which the insurer is legally required to pay.
- **Risk Assessment:** Start by assessing your personal and financial risks. Identify the areas where you need protection, such as health, life, property, or liability.
- **Diversify Coverage:** Consider a mix of insurance policies to cover different risks. This may include health insurance, life insurance, auto insurance, home insurance, and liability insurance.

8.10 SELF-ASSESSMENT QUESTIONS

1. Explain the insurance policy contract and its key elements.

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2. Discuss the rules of interpretation of insurance policy.

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8.11 SUGGESTED READING

- Inside the Insurance Industry by Kevin Glaser
- Insurance Law in India by K. B. Agrawal, Vandana Singh

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UNIT-II **LESSON NO. 9**

RISK ANALYSIS AND INSURANCE PLANNING

RISK ANALYSIS & iNSURANCE PLANNING

GENERAL INSURANCE, LIFE INSURANCE, MOTOR INSURANCE

STRUCTURE

9.1 Introduction

9.2 Objectives

9.3 Insurance Policies and Strategies in General Insurance

9.4 Meaning and Definition of Life Insurance

9.5 Types of Life Insurance Policies

9.6 Motor Insurance

9.7 Types of Motor Insurance Policies

9.8 Benefits of Motor Insurance Policies

9.9 Strategies of Motor insurance

9.10 Summary

9.11 Glossary

9.12 Self-Assessment Questions

9.13 Suggested Reading

9.11 INTRODUCTION

General insurance policies cover a wide range of risks, including property, liability, health, and more. General insurance policies provide financial assistance in case of damage to or loss of your insured asset, such as a car or a house. You must be aware that life insurance is protection against financial loss resulting from insured Individual's death. In legal terms life insurance is a contract the policy owner and the insurer, where the latter agrees to reimburse the occurrence of the insured individual's death or other event such as terminal illness or critical illness. The insured agrees to pay the cost in terms of insurance premium for the service. The elements of life insurance are risk coverage and savings for future. Life Insurance provides you and your family with protection against all the risks involved, moreover providing you an opportunity to grow your investments.

It could be viewed as a long-term investment to provide for your child's future expenses or your expenses, post retirement. It is the earnest desire of every individual to own property. Anyone who is in possession of something tangible feels secure. But very few people have adequate income to own something of their own. It is just they failed to plan and not planned to fail. It is very difficult to prepare a list of all financial needs. But it can be divided into capital needs like emergency funds, education needs, marriage needs and income needs like family income, retirement needs. Life Insurance has been recognized as one of the best instruments of family financial program.

9.2 OBJECTIVES

After reading the lesson, the student will help you to assess:

- Insurance Policies and Strategies in General Insurance
- Meaning and Definition of Life Insurance
- Types of Life Insurance Policies
- Motor Insurance
- Types of Motor Insurance Policies

- Benefits of Motor Insurance Policies vii.Strategies of Motor insurance

9.3 INSURANCE POLICIES AND STRATEGIES IN GENERAL INSURANCE

General insurance policies cover a wide range of risks, including property, liability, health, and more. General insurance policies provide financial assistance in case of damage to or loss of your insured asset, such as a car or a house. Here are some strategies and types of insurance policies to be considered

i. Types of General Insurance policy

ii. Health Insurance

As the name says, this type of insurance covers the expenses incurred due to any illness or medical emergency.

There are various types of health insurance available based on their coverage:

- Individual Health Insurance: Covers one policyholder.
- Family Floater Health Insurance: Covers the complete family under a single policy.
- Group Health Insurance: Covers the employees of an organization.

All the above types of health insurance further have different products under them based on their usage and many other factors. Here is a list of major types of health insurance products available in India:

- Senior Citizen Health Insurance
- Health Insurance
- Preventive Healthcare Plan
- Aarogya Sanjeevani
- Super Top-Up Insurance
- OPD Insurance
- Personal Accident Cover

2. Motor Insurance

If you own a vehicle, you will know that motor insurance is mandatory in India. The policy ensures that the vehicle has complete protection against physical damage from natural or artificial calamities and third-party liabilities arising from the insured vehicle.

Based on the type of vehicle they cover, Motor Insurance is broadly categorized into:

- Car Insurance
- Two-wheeler Insurance
- Commercial Vehicle Insurance

The different types of Motor Insurance Policies available in the market under the ones mentioned above are as follows:

- **Third-party insurance Policy:** Pays the financial liability to the third party affected in the mishap, ensuring you do not face legal hassle due to the accident.
- **Comprehensive Insurance Policy:** Apart from covering third-party liabilities, these plans also cover the expenses incurred for repairing the damages to the policyholder's vehicle due to an accident, fire, artificial and natural calamities, riots and other such instances.
- **Own Damage Policy:** With Own Damage Cover, you receive the same benefits as a comprehensive policy without the third-party liability portion of the policy.

There are many add-ons covers that can be added to your motor insurance policy to ensure that you are covered against any eventuality. Some add-on covers you can avail of are - Zero depreciation cover, Loss of personal belongings cover, Pay-as-you-drive cover, Daily conveyance cover, etc.

3. Travel Insurance

Travel Insurance provides financial protection to you and your family

when you are visiting any place in the country or abroad. It covers emergencies like loss of baggage, loss of passport, hijacking, medical emergencies, delayed flights, accidental deaths, adventure sports etc.

The major types of travel insurance are:

- Domestic Travel Insurance: For travel within the country
- International Travel Insurance: For travel outside the country
- Student Travel Insurance: If you are moving abroad for higher studies.

The above types further have a list of different products under them like Individual Travel Insurance, Family Travel Insurance, Senior Citizen Travel Insurance, Corporate Travel Insurance, Multi Trip Travel Insurance, Single Trip Travel Insurance and Schengen Travel Insurance.

4. Property Insurance

Another category of insurance is Property Insurance. A Property Insurance Policy provides financial reimbursement to the owner/renter of a building and its contents. It also covers damage caused to anyone other than the owner/renter if that person is injured on the property.

Some products available in the market under property insurance include:

- **Home Insurance:** Provides financial coverage in case of any significant damage to the insured home due to any reason like fire, theft, flood, storm etc.
- **Shop Insurance:** Covers the shop property and contents inside.
- **Burglary Insurance:** Covers any loss or damage due to unlawful breaking and entering of insured premises.
- **Office Insurance:** Office insurance provides coverage for the risks that can impact office operations like fire, burglary, misuse of office data, loss of money due to cheating of employees etc.
- **Fire Insurance:** Provides coverage against damage caused by any fire to property or assets.

5. **Commercial Insurance**

A Commercial Lines Insurance policy ensures that the business does not face any financial burden because of any financial and business risks. Apart from covering the damages to the property or employee injury, it also covers public or employer liability.

The policy is offered to commercial and business entities like large corporate houses, SMEs, and MSME industries.

Commercial Insurance, as an umbrella segment, has a number of Insurance types based on the type of asset covered, viz.:

- **Liability Insurance:** An insurance product that provides coverage against any claims resulting from injury or damage to any third party, i.e., person or property. It offers the following types of Liability Insurance Policies:
  * Directors and Office Liability Insurance
  * General Liability Insurance
  * Public Liability Insurance
  * Cyber Insurance
- **Marine Cargo Insurance:** This Insurance provides coverage for the inland transit of consignments. It covers the loss or damage of cargo or the means of its transportation between the point of origin and the final destination.
- **Engineering Insurance:** Engineering Insurance provides coverage against all risks associated with engineering and machinery. It includes the following insurance products:
  * Contractor's All-Risk Insurance
  * Erection All Risk Insurance
  * Plant and Machinery Insurance
- **Workmen Compensation Insurance:** Workmen Compensation

provides financial coverage to employees who get injured or die in any mishap during work. Thus, Workmen Compensation Insurance not only helps the employers to compensate these employees but also to fulfil their ethical duty as an employer.

- **Crop Insurance:** As the name suggests, Crop Insurance is bought by agriculturists to cover the financial losses that a bad crop season, crop failure or any other related menace might bring in.

Apart from the above major categories of General Insurance, there are a few more types as below:

6. Asset Insurance

There is no denying the fact that modern-day devices are making our lives simpler, richer and smarter. However, in case of any damage, they are usually expensive to be repaired. As the name suggests, Asset Insurance provides financial coverage to your assets like Mobile TVs, and other appliances or electronics.

7. Pet Insurance

The much-needed insurance cover for your furry babies because they need it as much as we do! Pet Insurance provides financial coverage for your pet's health and well-being requirements, such as any medical condition, such as pregnancy complications, dental treatments, and insect-borne diseases. Not just that, it also covers a lot of other conditions like pet theft, loss or damages to a third party because of the pet, accidents, overseas coverage and many more, depending on your insurance provider.

8. Bite-Size Insurance

Bite-size Insurance, also known as small-ticket insurance/sachet insurance, is a non- comprehensive plan which focuses on specific needs. They are available at a lower premium and can be availed without documentation/tests. Since these insurance plans are specific, they have limited but focused coverage. In fact, Bite-Size Insurance is a category

and not a type. It is unrestricted across all categories like health, travel, property etc.

Below are a few common Bite-Sized insurance products available in the market:

- Online Fraud Protection
- Cab Ride Insurance
- Backpack Insurance
- Marathon Insurance, and many more.

ii) **Coverage and limits:** when selecting an insurance policy, it is important to considered the coverage and limit of the policy. The coverage refers to what the policy covers, while the limit refer to the maximum amount the policy will pay out in case of a claim.

iii) **Claim Process:** In case of a claim, it is important to know the claim process of your insurance company. This includes the documents required to file a claim and the time it takes for the claim to be processed.

iv) **Insurance Business Strategy :** Insurance companies have re-designated their businesses, increased their presence and become more operationally efficient and effective.

It is important to consider the reputation and financial stability of the insurance company before selecting a policy. In summary, when considering general insurance policies, it is important to select the right type and amount of insurance based on your specific situation. It is also important to consider the coverage and limits of the policy, the premiums and deductibles, and the claim process of the insurance company.

9.4 MEANING AND DEFINITION OF LIFE INSURANCE

You must be aware that life insurance is protection against financial loss resulting from insured Individual's death. In legal terms life insurance is a contract the policy owner and the insurer, where the latter agrees to reimburse the occurrence of the insured individual's death or other event such as terminal

illness or critical illness. The insured agrees to pay the cost in terms of insurance premium for the service. The elements of life insurance are risk coverage and savings for future. Life Insurance provides you and your family with protection against all the risks involved, moreover providing you an opportunity to grow your investments. It could be viewed as a long- term investment to provide for your child's future expenses or your expenses, post retirement. It is the earnest desire of every individual to own property. Anyone who is in possession of something tangible feels secure. But very few people have adequate income to own something of their own. It is just they failed to plan and not planned to fail. It is very difficult to prepare a list of all financial needs. But it can be divided into capital needs like emergency funds, education needs, marriage needs and income needs like family income, retirement needs. Life Insurance has been recognized as one of the best instruments of family financial program. Usually people look at investment in life Insurance as risk cover/investment, combination of both the above, adequately long term, safe investment, moderate yield and tax savings. The need levels of individuals in Life Insurance naturally depend on the age group. Every one of us has the following Insurance needs at every point of our life. But the degree of need depends on age. The recognized needs are protection for self and family, children needs, retirement needs, special needs like health and housing. Several definitions of life insurance contract have been given from time to time by learned persons, Judges and in the insurance legislation as under:

A contract of life insurance is that in which one party agrees to pay a given sum on the happening of a particular event contingent upon the duration of human life, in consideration of the immediate payment of a smaller sum or certain equivalent periodical payments by another. **– Bunion**

Life Insurance contract may be defined whereby the insurer, in consideration of a premium paid either in lump sum or in periodical instalments, undertakes to pay an annuity of a certain sum of money either on the death of the insured or on the expiry of a certain number of years.

– R.S. Sharma

9.5 TYPES OF LIFE INSURANCE POLICIES:

1. Term Life Insurance or Term Plan

Term life insurance is the most popular type of life insurance. It is widely considered to be the simplest and purest form of life insurance. It offers a death benefit to the beneficiaries of the policy if the policyholder passes away during the policy term.

Term insurance is the most affordable types of life insurance. The most distinctive feature of this plan is the high amount of coverage offered at extremely nominal premium rates. It is thus cheaper than other types of life insurance policies. In general, term life insurance does not offer maturity benefits. But certain types of term plans also offer maturity benefits, i.e., term plan with return of premiums (TROP) if the policyholder outlives the policy term. One can also increase the amount of coverage offered by a term plan by opting for additional riders, such as Accidental Death Benefit or Child Support riders.

2. Whole Life Insurance Plan

Whole life insurance is a type of life insurance that offers coverage right until the death of the policyholder. In this policy, you can opt for either a participating or non-participating policy, as per your financial needs and risk appetite. Though the premiums for participating whole life insurance are higher in comparison, dividends are paid out at regular intervals to the policyholders.

The premium rates for a non-participating policy are lower, but the policyholder generally cannot avail the benefits of regular dividends.

3. Unit Linked Insurance Plan (ULIP)

Unit Linked Insurance Plan or ULIP is a type of life insurance product that offers dual benefits of investment and life insurance. Among the different types of life insurance policies available, ULIPs enjoy a high amount of popularity owing to their versatile nature. A portion of the premiums paid is directed towards ensuring insurance coverage, while

the rest of the premium is invested into a bouquet of investment instruments, which can include market-backed equity funds, debt funds and other securities. ULIPs are extremely flexible instruments since investors can easily switch or redirect their premiums between the different funds available. They are also touted as having an edge over other market instruments in terms of tax-saving benefits, since their proceeds are exempted from LTCG (Long Term Capital Gains).

4. Endowment Policy

Endowment Policy is a type of life insurance policy which acts as, both, an instrument for insurance and saving. These plans aim to provide maturity benefits to the life insured, in the form of a lump sum payment at the end of the policy tenure, even if a claim hasn't been made. It is the most suitable types of life insurance for people looking to get maximum coverage alongside having a sizable savings component. They help the policyholder inculcate the habit of savings, even while providing financial security to their family. Endowment plans can broadly be classified into two types: with profit and without profit. Policyholders can choose from these two types based on their risk appetite.

5. **Money Back Policy**

Being one of the best types of life insurance policies, a money-back policy offers policyholders a percentage of the total sum assured at periodic intervals in the form of Survival Benefits. Once the policy reaches maturity, the remaining amount of the Sum Assured is handed over to the policyholder. However, if the policyholder dies while the term is ongoing, their dependents are given the entire Sum Assured without any deductions.

6. Retirement Plan

A retirement plan is a type of life insurance that focuses on providing you financial stability and security post your retirement. After you retire, you lose your regular income from employment. Investing in retirement

plans can help you create a stable regular income stream. If you continue to invest until retirement, the plan will help you take care of your expenses after retirement. It requires you to invest a certain part of your income regularly during your working life. At the time you retire, the amount that you create over the years will be converted into a regular income stream. Retirement plans also involve death benefits. Thus, if the policyholder passes away during the course of the policy, their beneficiaries will be provided with an assured sum.

7. Child Insurance

A child insurance plan is a savings cum investment plan that provides financial protection for the child's future upon the unfortunate demise of the policyholder. It is ideal for ensuring the future needs of the child are well taken care of, even in the absence of the life insured. Parents can invest in the best child insurance plans, in order to meet the financial requirements for their child's education, marriage or to fulfil a multitude of other financial goals their child might have.

8. **Group Insurance Plan**

A group life insurance policy is a type of life insurance that covers a group of people inside a single insurance policy. Unlike individual life insurance policies, which cover one person for a period, group insurance covers a minimum of 10 members. Employers, banks, corporates, and other homogeneous groups of persons can buy group Life Insurance policies for their employees and customers. While employers would want to offer financial protection to their employees' families banks and lending institutions aim to keep the debt off the borrowers' family after their death.

a. The plan under which the group is covered is called the Master Plan.

b. The policy is issued to the manager of the group (master) but will remain in the name of the group only.

For example, Ram is the manager of a firm, to protect his employees,

he has taken a group insurance policy. Now the policy will be issued to Ram in the name of the firm. One of the distinct features of these life insurance policies is that you get insurance till the time you are part of the group. If you leave the group, your cover ceases to exist.

9. **Savings and Investment Plan**

Savings and investment plans from life insurance are the plans which channel your regular savings into long-term investment goals. iSelect Guaranteed Future is a life insurance cum savings plan that offers a life cover along with guaranteed maturity benefits. With this, you can plan your investments so that you can achieve your life goals smoothly. You can also protect your financial goal with a premium protection option. This option allows the planned investments to continue even after your demise.

9.6 MOTOR INSURANCE

Motor insurance is a crucial aspect of owning a car, motorbike or any other vehicle. It provides financial protection against unexpected events such as accidents, theft or damages caused to third parties. At Liberty General Insurance (LGI), we offer comprehensive insurance solutions for both cars and two-wheelers. Our aim is to offer reliable and robust coverage to protect your vehicles from unexpected events and provide you with peace of mind on the road.

9.7 TYPES OF MOTOR INSURANCE POLICIES

i. **Car Insurance:** Car insurance is the most common type of vehicle insurance. It offers protection for cars against damages due to accidents, theft, natural disasters and vandalism. Comprehensive car insurance provides coverage for both third-party liability and damages to your own vehicle. When you choose Liberty General Insurance (LGI) for your car insurance, you get more than basic protection. You receive comprehensive coverage that protects against damages to your vehicle and third-party liabilities as required by law.

ii. **Two-Wheeler Insurance:** Two-wheeler insurance, also known as bike insurance, is designed specifically for motorcycles, scooters and other two-wheeled vehicles. Similar to car insurance, it provides coverage for accidents, theft, third-party liability and damages to your own vehicle. Liberty General Insurance provides two types of two-wheeler insurance policies: a standard annual policy and a multi-year plan.

9.8 BENEFITS OF MOTOR INSURANCE POLICIES

- **Financial Protection:** The primary benefit of vehicle insurance is financial security. In the event of an accident, insurance coverage can help cover repair costs, medical expenses or even legal liabilities, depending on the policy.
- **Third-Party Liability Coverage:** Vehicle insurance policies include coverage for damages caused to third parties. This means that if you are involved in an accident that causes injury or property damage to someone else, your insurance will cover the costs, protecting you from potential legal consequences.
- **Peace of Mind:** Having vehicle insurance provides peace of mind, knowing that you are financially protected against unforeseen circumstances. It allows you to drive or ride with confidence, knowing that you have coverage in case of accidents, theft or damages.

Experience a range of features with the motor insurance policy offered by Liberty General Insurance. Enjoy hassle-free claims, easy policy transfer, availability of additional protection, efficient telephonic services and a paperless experience. We strive to provide you with a seamless and convenient insurance experience for your motor vehicle.

9.9 STRATEGIES OF MOTOR INSURANCE

1. **Assess Your Needs:** Consider your vehicle type, usage and personal requirements. Evaluate whether you need comprehensive coverage or third-party liability insurance.

2. **Research and Compare:** Research different insurance providers and policies. Compare their coverage options, premiums, deductibles, claim settlement process, customer reviews and overall reputation.

3. **Evaluate Add-Ons:** Many vehicle insurance policies offer additional add-ons or riders that provide extra coverage for specific situations. Examples include zero depreciation cover, roadside assistance, engine protection and personal accident cover.

4. **Consider Online Purchase:** Buying car or bike insurance online offers convenience and often provides competitive prices. Skip the hassle of visiting a branch and purchase your vehicle insurance online with Liberty General Insurance.

5. **Read the Policy Document:** Before finalising your decision, carefully read the policy document to understand the coverage, terms and conditions.

9.10 SUMMARY

Life Insurance has been recognized as one of the best instruments of family financial program. Usually, people look at investment in life Insurance as risk cover/investment, combination of both the above, adequately long term, safe investment, moderate yield and tax savings. The need levels of individuals in Life Insurance naturally depend on the age group. Every one of us has the following Insurance needs at every point of our life. But the degree of need depends on age. The recognized needs are protection for self and family, children needs, retirement needs, special needs like health and housing. Several definitions of life insurance contract have been given from time to time by learned persons, Judges and in the insurance legislation as under: A contract of life insurance is that in which one party agrees to pay a given sum on the happening of a particular event contingent upon the duration of human life, in consideration of the immediate payment of a smaller sum or certain equivalent periodical payments by another.

9.11 GLOSSARY

1. **Term Life Insurance or Term Plan:** Term life insurance is the most popular type of life insurance. It is widely considered to be the simplest and purest form of life insurance.
2. **Whole Life Insurance Plan:** Whole life insurance is a type of life insurance that offers coverage right until the death of the policyholder.
3. **Money Back Policy:** Being one of the best types of life insurance policies, a money-back policy offers policyholders a percentage of the total sum assured at periodic intervals in the form of Survival Benefits.
4. **Retirement Plan:** A retirement plan is a type of life insurance that focuses on providing you financial stability and security post your retirement.

9.12 SELF-ASSESSMENT QUESTIONS

1. Critically evaluate the insurance policies and strategies in general insurance.

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2. Discuss the various types of life insurance policies.

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3. What do you mean by motor insurance? Explain the benefits of motor insurance.

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9.12 SUGGESTED READING

- Life Insurance: A Textbook by Huebner, Solomon S
- Inside the Insurance Industry by Kevin Glaser
- Motor Insurance Simplified Mohammed Sadullah Khan
- Insurance Law in India by K. B. Agrawal, Vandana Singh

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UNIT-II LESSON NO. 10

RISK ANALYSIS AND INSURANCE PLANNING

MEDICAL INSURANCE AND REGULATION OF INSURANCE INDUSTRY

STRUCTURE

10.1 Introduction

10.2 Objectives

10.3 Medical Insurance

10.4 Benefits of Medical Insurance

10.5 Medical Insurance Policies

10.6 Medical Insurance Strategies

10.7 Insurance Of Business Risk

10.8 Regulation of Insurance Industry

10.9 Establishment of IRDA

10.10 Objective of IRDA

10.11 Role of IRDA in the Indian Insurance Sector

10.12 How does IRDA work?

10.13 Features of IRDA

10.14 Benefits of IRDA

10.15 Summary

10.16 Glossary

10.17 Self-Assessment Questions

10.18 Suggested Reading

10.1 INTRODUCTION

Health insurance is a type of insurance that covers medical expenses that arise due to an illness. These expenses could be related to hospitalization costs, cost of medicines or doctor consultation fees. Every individual has different requirements from their insurance plan, depending on their financial situation. Therefore, you must be exceptionally careful and thorough while investing in a health plan. It is a critical life decision that will impact your future significantly. Consequently, it is essential to understand the types of health insurance plans available today to provide optimum coverage for yourself and your loved ones. Anybody who has a health insurance policy will tell you that buying one is one of the smartest financial decisions by any earning individual. Now, that you have decided to buy a health insurance policy, you need to know how to select a good health insurance plan that will take care of all your needs. Here is a list of benefits any good health insurance plan should offer you:

1. Protection against a large number of critical illnesses
2. Flexibility to choose your health cover
3. No increase in premiums during the policy term even if your health condition changes
4. Long policy term that covers you even in your old age
5. Large hospital network for easy access to medical treatment

10.2 OBJECTIVES

After reading the lesson, the student will help you to assess:

- Meaning and benefits of Medical Insurance
- Various Medical Insurance Policies
- Medical Insurance Strategies
- Insurance of Business Risk
- Regulation of Insurance Industry

- Establishment of IRDA
- Objective of IRDA
- Role of IRDA in the Indian Insurance Sector
- How does IRDA work?
- Features of IRDA
- Benefits of IRDA

10.3 MEDICAL INSURANCE

Health insurance is a type of insurance that covers medical expenses that arise due to an illness. These expenses could be related to hospitalisation costs, cost of medicines or doctor consultation fees.

10.4 BENEFIT OF MEDICAL INSURANCE

1. Optimum Coverage

The principal reason to know what is medical insurance and buy it is to create a financial shield for your future. There are several kinds of health insurance plans available to cater to specific requirements. It is crucial to understand your financial needs and choose a suitable policy.

A carefully selected plan will provide optimum coverage, including regular check-up expenses, ambulance expenses, hospitalization charges, alternative treatment, and more. Some policies also offer coverage for treatment at home under medical supervision as a part of domiciliary treatment. Make sure you understand health insurance meaning in various facets before you choose a plan.

2. Cash Less Claim Benefit

To make things easier, most insurance companies offer cashless treatment at hospitals. The insurance providers have tie-ups with certain hospitals for such cases. It means that you do not have to pay medical bills directly when you avail of treatment in a network hospital.

The expenses are settled between the hospital and the insurance provider. In the case of an unforeseen medical emergency, cashless treatment can be incredibly helpful.

3. **Additional Protection**

   Most employers provide health insurance for their employees. However, many people find it to be unsuitable to their specific requirements. It may also be affected by a change in employment. A health insurance policy of your choice will put your mind at ease. A plan that is customized to your requirements will offer better security and stability.

   Furthermore, several riders can be attached to your existing plan and expand the scope of security.

   For example, the critical illnesses rider offers protection against life-threatening diseases such as cancer, heart attacks, kidney failure, and more.

4. **Tax Benefits**

   One of the most significant benefits of investing in a health insurance plan is the tax benefits. Manypeople find it to be a substantial incentive behind opting for health policy. It is so because tax relief is a massive advantage for an individual's ongoing expenses.

10.5 MEDICAL INSURANCE POLICIES

Every individual has different requirements from their insurance plan, depending on their financial situation. Therefore, you must be exceptionally careful and thorough while investing in a health plan. It is a critical life decision that will impact your future significantly. Consequently, it is essential to understand the types of health insurance plans available today to provide optimum coverage for yourself and your loved ones.

There are two categories of health insurance policies.

1. Indemnity Plans
2. Defined-Benefit Plans

1. **Indemnity Plans**

- **Mediclaim Insurance :** This provides compensation for the hospitalization expenses that occur due to accidental stay or illnesses. It includes nursing charges, surgery expenses, oxygen, anesthesia, doctor's fee, etc.
- **Individual Insurance :** This is the most common type of health plan available. As the name suggests, it is meant for the insured individual only. The payable premium depends upon the insured individual's age, medical history, and other relevant factors. You can add additional members to the plan by paying an extra premium.
- **Family Floater Insurance :** It provides coverage for the entire family under a single premium amount. This amount is comparatively lesser than that of an individual health plan. For a family with no significant health issues, this option might be preferable. However, if there is a family member with severe health issues, they might require a sizable amount of the sum insured, which will leave other members with a lesser coverage amount.
- **Unit Liked Health Insurance :** Commonly known as ULIPs, this plan is a combination of investment and insurance coverage. A portion of the premium amount is invested in mutual funds while the rest of it goes into securing insurance. The returns are subject to market performance.
- **Group Mediclaim :** This is a popular choice among large and medium scale enterprises. It offers health coverage for the employees under a common plan.

2. **Definite-Benefit Plans**

These are the type of health plans that provide compensation for a lump sum amount when the insured is detected with an illness. Here are the plans included:

- **Critical Illness Plan :** This plan offers a pre-determined amount of compensation upon regardless of pre or post-hospitalization charges.

These critical illnesses majorly include life-threatening diseases such as cancer, multiple sclerosis, paralysis, kidney failure, stroke, paralysis, and more.

- **Hospital Daily Cash Benefit Plan :** Under this plan, a pre-set sum assured is offered as compensation for each day of hospitalization. These plans are available as standalone covers or riders.
- **Personal Accident Plan :** This plan provides compensation in case of an accidental injury or demise. Some Plans also cover loss of income due to a temporary permanent disability rendering a person unfit to go back to work for a few days.

10.6 MEDICAL INSURANCE STRATEGIES

Anybody who has a health insurance policy will tell you that buying one is one of the smartest financial decisions by any earning individual. Now, that you have decided to buy a health insurance policy, you need to know how to select a good health insurance plan that will take care of all your needs. Here is a list of benefits any good health insurance plan should offer you:

1. Protection against a large number of critical illnesses
2. Flexibility to choose your health cover
3. No increase in premiums during the policy term even if your health condition changes
4. Long policy term that covers you even in your old age
5. Large hospital network for easy access to medical treatment

10.7 INSURANCE OF BUSINESS RISK

Business risk insurance, often referred to as business insurance or commercial insurance, is a type of coverage that helps protect a business from various risks and potential financial losses. It can include several types of insurance policies, such as:

i. **Property Insurance:** This covers damage or loss of physical assets,

such as buildings, equipment, and inventory due to events like fire, theft, or natural disasters.

ii. **Liability Insurance:** This provides protection in case your business is held liable for injury, damage, or harm to others. It can include general liability, professional liability, and product liability insurance.

iii. **Business Interruption Insurance:** This covers income losses and operating expenses if your business is unable to operate due to a covered event (e.g., a fire that forces a temporary shutdown).

iv. **Workers' Compensation:** This is typically required by law and provides coverage for employee injuries or illnesses that occur while on the job.

v. **Cyber Insurance:** This protects against losses related to data breaches, cyberattacks, and other technology-related risks.

vi. **Commercial Auto Insurance:** If your business uses vehicles, this covers them in case of accidents or damage.

vii. **Directors and Officers (D&O) Insurance:** This protects the personal assets of company directors and officers if they are sued for alleged wrongful acts in managing the company.

viii. **Key Person Insurance:** This helps a business recover from the loss of a crucial employee, such as the founder or a key executive.

ix. **Fidelity Bonds:** These protect against losses due to employee theft, fraud, or dishonesty.

x. **Environmental Insurance:** Covers liability and cleanup costs associated with environmental damage caused by your business.

The specific insurance needs of a business can vary greatly depending on the industry, size, location, and other factors. It's important for business owners to assess their risks and consult with insurance professionals to tailor a coverage plan that suits their needs.

10.8 REGULATION OF INSURANCE INDUSTRY

Insurance is a big part of every economy. It helps minimize risks. People can take policies to protect themselves from financial losses. These policies are for different measures. One may take it for their health or property. The company becomes liable to pay if any financial loss occurs. These insurance businesses have set terms. Policyholders only get the claims if these conditions are met. Also, these businesses have to follow the government guidelines. They have a regulatory framework of insurance. It is by the Insurance Regulatory and Development Authority. All life or other general insurance companies must follow its rules. It helps protect the policyholders' interests.

IRDA: The IRDA sets the regulatory framework of insurance. It's the Insurance Regulatory and Development Authority. This authority controls the Indian insurance domain. It sets rules that are necessary for all insurance companies.

- The insurance sector is a large one. Several Indians take various insurance policies.
- These range from protecting their health to properties. The holders get claims if those events happen and they incur a loss.
- Companies provide these insurance policies. There are both government and private players. These companies have a regulatory framework of insurance. It details the rules and oversees their functions.
- The Insurance Regulatory and Development Authority is at this helm. It sets the rates or charges for insurance as well.
- This body aims at an efficient insurance system. It promotes the well-being of India's insurance market.
- Also, the policyholder interests are its aim. The policies are thus formed keeping these in mind.

All insurance companies must adhere to the regulatory framework of insurance. It ensures that there are no downsides. The policyholders can get beneficial insurance to cover their risks. These policies are for uncertain and calculable financial losses.

10.9 ESTABLISHMENT OF IRDA:

The regulatory framework of insurance is integral to the IRDA. Read below to understand its establishment.

- The IRDA began back in 2000. Earlier, the Indian government regulated the insurance sector.
- The IRDA was formed as per the Malhotra Committee reports in 1999. It was a stand-alone insurance apex body.
- The IRDA started registration applications through invites in August 2000. Foreign companies could also invest up to 26% in this insurance market.
- This regulating body has defined rules under the Insurance Act of 1938 and Section 114A.
- These regulations cover rules for protecting policyholders' interests. Also, it has details for insurance business registrations.
- There are 33 general insurance businesses. The life insurance companies are 24 currently in India. These details cover the regulatory framework of insurance. It started back in 2000 and now has several private and government insurance businesses.

10.10 OBJECTIVE OF IRDA

The regulatory framework of insurance has several objectives.

- The IRDA aims to promote the policyholders' rights and interests.
- This organization aims for the insurance industry growth.
- There should be swift insurance claims. Also, the body seeks the prevention of fraud in the industry.
- The IRDA ensures transparency in the insurance market. Also, the rules provide orderly conduct.
- IRDA regularly creates rules for better insurance market functioning. It helps create an overall better economic environment.

10.11 ROLE OF IRDA IN THE INDIAN INSURANCE SECTOR

The regulatory framework of insurance has an integral role. It governs the entire market and provides for better functioning. Read below the role of IRDA.

- **Policy holder interests:** The IRDA aims to make insurance better for clients. They work to make easy laws. It helps get easy claims.
- **Industry growth:** The regulatory framework of insurance is a growth driver. It helps create laws that make market entry easier. Businesses can easily enter. Also, customers have better insurance policies and rules.
- **Fundings:** The IRDA helps increase market funding. It promotes long-term growth for the insurance industry.
- **Fair dealings:** The regulatory framework of insurance oversees the industry's work. It helps set higher integrity standards and rules. This also leads to fair dealings for insurance claims.
- **Grievance address:** The IRDA has set a regulatory framework and grievance forums. These bodies help clients complain if they aren't treated correctly.
- **Regulation:** This body takes regulatory actions if the companies don't follow the rules. It helps in better overall functioning for the market.

These roles are all part of the regulatory framework of insurance. Businesses need to know these rules. Also, clients should understand their rights and enforce the same.

10.12 HOW DOES IRDA WORK?

A regulatory framework of insurance is necessary. Without these rules, the marker would all be in turmoil. There would be increased fraud, and people wouldn't trust the system. Thus, they wouldn't take insurance as well. It would further lead to economic instability with high losses. That's why the working of IRDA is integral. Read below to understand the same.

- IRDA rules should not have any ambiguity. It means that businesses should fully understand the rules and follow the same.
- IRDA is the registration body. It issues the companies their registrations. Thus, every new insurance business goes through the regulatory framework of insurance.
- IRDA independently creates rules. These regulations focus on policyholders and market growth.
- Ensures a fair settlement for genuine claims. Insurance companies cannot deny claims if all conditions are correct.
- Insurance intermediaries or companies must follow a conduct code. The regulatory framework of insurance enforces it.
- IRDA settles disputes in the industry. IRDA also regulates insurance rates. It helps ensure that clients don't face high hikes for premiums.
- IRDA ensures the development of both rural and urban insurance markets. It sets percentages for insurance companies for insurance policies in different areas.

The regulatory framework of insurance thus covers all these aspects. The IRDA covers everything from basic registration rules to ensuring rural access.

10.13 FEATURES OF IRDA

The regulatory framework of insurance body has the following features.

- It is a regulatory body. IRDA covers rules and enforces the same.
- IRDA protects policyholders. It ensures no fraud and swift claims.
- Section 114A of the 1938 Insurance Act covers the rules. The IRDA defines the different guidelines in this section.
- It grants registration certificates. The Insurance Act grants this responsibility to the IRDA.

- This body oversees both the companies and the overall market. It helps in sustained development.

10.14 BENEFITS OF IRDA

The regulatory framework of insurance has these advantages.

- It prioritizes the policyholders. The policies are made as per their benefits.
- The IRDA oversees the insurance market. It ensures that companies follow the rules.
- IRDA prevents fraud. It regulates all the insurance businesses.
- IRDA settles disputes for insurance. It helps in quick settlements for claims.
- IRDA prevents high increases in insurance rates. It makes the policies more affordable.

10.15 SUMMARY

The IRDA sets the regulatory framework of insurance. It's the Insurance Regulatory and Development Authority. This authority controls the Indian insurance domain. It sets rules that are necessary for all insurance companies.

- The insurance sector is a large one. Several Indians take various insurance policies.
- These range from protecting their health to properties. The holders get claims if those events happen and they incur a loss.
- Companies provide these insurance policies. There are both government and private players. These companies have a regulatory framework of insurance. It details the rules and oversees their functions.
- The Insurance Regulatory and Development Authority is at this helm. It sets the rates or charges for insurance as well.
- This body aims at an efficient insurance system. It promotes the well-being of India's insurance market.

- Also, the policyholder interests are its aim. The policies are thus formed keeping these in mind.

All insurance companies must adhere to the regulatory framework of insurance. It ensures that there are no downsides. The policyholders can get beneficial insurance to cover their risks. These policies are for uncertain and calculable financial losses.

10.16 GLOSSARY

i. **Individual Insurance :** This is the most common type of health plan available. As the name suggests, it is meant for the insured individual only. The payable premium depends upon the insured individual's age, medical history, and other relevant factors.

ii. **Family Floater Insurance :** It provides coverage for the entire family under a single premium amount. This amount is comparatively lesser than that of an individual health plan.

iii. **Unit Linked Health Insurance :** Commonly known as ULIPs, this plan is a combination of investment and insurance coverage. A portion of the premium amount is invested in mutual funds while the rest of it goes into securing insurance.

10.17 SELF-ASSESSMENT QUESTIONS

1. Discuss the various medical insurance policies and strategies.

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2. Explain the establishment and objectives of IRDA.

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3. Critically evaluate the regulation of insurance industry.

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10.18 SUGGESTED READING

- Mediclaim and Health Insurance by Kshitij Patukale
- Financial planning by M. Sinha
- Investment Planning, Tax Planning and Estate Planning by Indian Institute of Banking and Finance
- Direct Taxes Law and Practice by V.K. Singhania & K. Singhania.

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UNIT-III **LESSON NO. 11**

RETIREMENT PLANNING AND EMPLOYEE BENEFITS

RETIREMENT PLANNING AND EMPLOYEE BENEFITS

STRUCTURE

11.1 Introduction

11.2 Objectives

11.3 Retirement Need Analysis : Concept

11.4 Retirement Need Analysis Techniques

11.5 Meaning of Retirement Planning

11.6 Need for Retirement Planning

11.7 Process of Retirement Planning

11.8 Sources of Retirement Planning

11.9 Development of Retirement Plans

11.10 Summary

11.11 Glossary

11.12 Self-Assessment Questions

11.13 Suggested Reading

11.1 INTRODUCTION

Retirement needs analysis refers to the process of evaluating an individual's financial situation, goals, and lifestyle to determine how much

money they will need to maintain their desired standard of living during retirement. It involves assessing various factors, such as current savings, expected expenses, inflation, and investment returns, to create a plan that ensures a financially secure retirement. This analysis helps people make informed decisions about savings, investments, and retirement contributions to meet their future financial requirements. Certainly, retirement need analysis is an essential step in financial planning. Retirement scheme means agreements or arrangements (whether legally enforceable or not) for the payment of any pensions, allowances, lump sums or other like benefits on retirement or on death or during periods of sickness or disablement for the benefit of any present or former director, officer or employee of any Group Company or for the benefit of the dependents of any such persons.

11.2 OBJECTIVES

After reading the lesson, the student will help you to assess:

- Retirement Need Analysis
- Retirement Need Analysis Techniques
- Meaning of Retirement Planning
- Needs for Retirement Planning
- Process of Retirement Planning
- Sources of Retirement Planning
- Development of Retirement Plans

11.3 RETIREMENT NEEDS ANALYSIS

Retirement needs analysis refers to the process of evaluating an individual's financial situation, goals, and lifestyle to determine how much money they will need to maintain their desired standard of living during retirement. It involves assessing various factors, such as current savings, expected expenses, inflation, and investment returns, to create a plan that ensures a financially secure retirement. This analysis helps people make informed

decisions about savings, investments, and retirement contributions to meet their future financial requirements. Certainly, retirement need analysis is an essential step in financial planning. To get started, you should consider the following:

i. **Determine your retirement age:** Decide when you plan to retire, as this will impact the length of your retirement and the amount you need to save.

ii. **Estimate your expenses:** Calculate your expected annual expenses in retirement, including housing, healthcare, groceries, travel, and other discretionary spending.

iii. **Assess your income sources:** Consider your expected retirement income, such as Social Security, pensions, and any other sources.

iv. **Calculate the retirement savings gap:** Subtract your expected retirement income from your estimated expenses to determine how much you need to save.

v. **Account for inflation:** Remember that the cost of living will likely increase during your retirement, so adjust your calculations for inflation.

vi. **Set retirement goals:** Define your financial goals for retirement, which can help guide your savings and investment strategies.

vii. **Plan for unexpected expenses:** Consider factors like healthcare costs and emergencies when estimating your retirement needs.

viii. **Consult a financial advisor:** Seek professional advice to create a personalized retirement plan and investment strategy.

Remember that your retirement needs can vary significantly based on your lifestyle, location, and other personal factors. Regularly review and adjust your plan as your circumstances change.

11.4 RETIREMENT NEED ANALYSIS TECHNIQUES:

Analyzing retirement needs involves assessing various financial and lifestyle factors to determine how much money you'll need to retire comfortably. Here are some techniques to help with retirement need analysis:

i. **Budgeting:** Start by creating a detailed budget that outlines your current expenses. This will give you a baseline for estimating your future retirement expenses.

ii. **Inflation Adjustment:** Consider the impact of inflation on your future expenses. Use historical averages to adjust your projected expenses accordingly.

iii. **Income Sources:** Identify potential sources of income during retirement, such as Social Security, pensions, investments, and part-time work.

iv. **Life Expectancy:** Estimate your life expectancy. You can use actuarial tables or online calculators to get a rough idea. Plan for a longer retirement to ensure you don't outlive your savings.

v. **Rate of Return:** Estimate the rate of return on your investments. This will impact how your savings grow over time. Be conservative in your assumptions.

vi. **Emergency Fund:** Ensure you have an emergency fund to cover unexpected expenses, so you don't need to dip into your retirement savings.

vii. **Debts:** Pay off high-interest debts before retirement. Reducing or eliminating debt will lower your monthly expenses.

viii. **Healthcare Costs:** Consider rising healthcare costs as you age. Medicare and supplemental insurance are important for covering medical expenses.

ix. **Lifestyle Expectations:** Think about your desired lifestyle in retirement. Will you travel, downsize, or have different housing needs? Adjust your budget accordingly.

x. **Long-Term Care:** Plan for potential long-term care expenses, which can be substantial. Long-term care insurance may be a consideration.

xi. **Tax Considerations:** Understand how your retirement income will be taxed. Some accounts, like Roth IRAs, offer tax advantages.

xii. **Professional Help:** Consult with a financial advisor or retirement planner. They can create detailed projections and help you make informed decisions.

xiii. **Regular Review:** Continuously review your retirement plan. As life circumstances change, adjust your plan accordingly.

xiv. **Monte Carlo Simulations:** These simulations can model different investment scenarios to estimate the probability of your retirement savings lasting through various market conditions.

xv. **Retirement Calculators:** Use online retirement calculators to get a rough estimate of how much you'll need. Many financial websites offer these tools.

Remember that retirement planning is a dynamic process, and it's essential to stay flexible and adaptable as your financial situation and goals evolve. Regularly revisiting and adjusting your retirement plan will help ensure you're on track to meet your financial needs in retirement.

11.5 MEANING OF RETIREMENT PLANNING

Retirement planning, in a financial context, refers to the allocation of finances for retirement. This normally means the setting aside of money or other assets to obtain a steady income retirement. The goal of retirement planning is to achieve financial independence, so that the need to be gainfully employed is optional rather than a necessity.

The process of retirement planning aims to:

- Determine one's financial fitness for retirement based on intended retirement age and lifestyle; and
- Identify strategies to increase retirement preparation

11.6 NEED FOR RETIREMENT PLANNING

We must first comprehend why we must take control of our retirement before we can talk about how to prepare a good retirement plan. This may

sound like a silly question, but you might be startled to hear that the fundamentals of retirement planning go against the grain of conventional wisdom on the most effective method of saving money for the future. Furthermore, ensuring appropriate execution of those crucial elements is crucial to securing a comfortable retirement. This entails investigating all potential retirement income sources.

1. **Longer Life Expectancy:** People are living longer than ever before, which means that retirement planning is more important than ever to ensure that you have enough money to last throughout your lifetime.

2. **Inflation:** Inflation can erode the purchasing power of your retirement savings over time, making it important to plan for rising costs in retirement.

3. **Uncertainty:** There are many uncertainties in life, such as health problems, unexpected expenses, and changes in the economy. Retirement planning can help you prepare for unexpected events.

4. **Changing Social Security Benefits:** Social Security benefits may change in the future, and retirement planning can help you prepare for those changes.

5. **Medical Expenses**: Healthcare costs are rising, and many people underestimate the cost of healthcare in retirement. Retirement planning can help you plan for these expenses.

6. **Dependents:** If you have dependents, such as children or elderly parents, retirement planning can help ensure that you have enough money to take care of them.

7. **Lifestyle:** Retirement planning can help you achieve the lifestyle you want in retirement, whether that means traveling, pursuing hobbies, or spending time with family and friends.

8. **Debt:** If you have debt, such as a mortgage or credit card debt, retirement planning can help you create a plan to pay off your debt before you retire.

9. **Tax Implications:** Retirement planning can help you understand the tax implications of your retirement savings and help you create a tax efficient retirement strategy.

10. **Peace of Mind:** Retirement planning can provide peace of mind knowing that you have a plan in place to achieve your retirement goals and to be financially secure in retirement.

11.7 PROCESS OF RETIREMENT PLANNING

The process of retirement planning involves several steps, including**:**

1. **Set your retirement goals:** Identifying your retirement goals is the first step in retirement planning. This include choosing your retirement age, figuring out how much money you'll need, and deciding on the lifestyle you wish to lead.

2. **Make a retirement savings calculation:** The amount of money you will need to save in order to reach your retirement goals must then be determined. Calculating any sources of retirement income, such as Social Security or a pension, as well as your anticipated retirement costs, including those for housing, healthcare, and daily living, is necessary.

3. **Develop a retirement plan:** You can create a retirement plan once you've calculated your financial requirements and retirement goals. A retirement income strategy, tax-saving strategies, and investment decisions that are suitable for your risk profile and time horizon are all included in this.

4. **Review and adjust your retirement plan:** Retirement planning is a continuous process, therefore it's crucial to regularly examine and modify your strategy. This entails keeping an eye on the performance of your retirement investments and savings, modifying your retirement income strategy as necessary, and updating your retirement plan when your personal circumstances change.

5. **Implement your retirement plan:** Finally, you must put your retirement plan into action by funding your retirement accounts, making wise

investment decisions, and taking measures to reduce your tax liability. To give your retirement savings time to develop, it's crucial to start carrying out your retirement plan as soon as you can.

11.8 SOURCES OF RETIREMENT PLANNING

People can use a variety of retirement planning resources in India to assist them in making retirement plans. Typical sources include:

1. **Employee Provident Fund (EPF):** The majority of employees in India are required to participate in the government-sponsored EPF retirement scheme. Both employers and employees make contributions to the retirement fund, which is accessible upon retirement.

2. **National Pension System (NPS):** All Indian nationals are eligible for the government- sponsored NPS retirement programme. The NPS accepts contributions from individuals, and the money is invested in a combination of government securities, debt, and equity.

3. **Public Provident Fund (PPF) :**PPF is a savings programme offered by the government that is accessible to all Indian citizens. Tax deductions are available for PPF contributions, and the funds' growth is tax-free. Additionally, withdrawals are tax-free.

4. **Individual Retirement Accounts (IRAs):** In addition to EPF, NPS, and PPF, individuals can also open IRAs to save for retirement. There are two types of IRAs in India: traditional and Roth.

5. **Life insurance policies:** Life insurance policies can provide a source of retirement income in India. Some life insurance policies offer a lump-sum payout at the end of the policy term, while others provide regular payouts throughout retirement.

6. **Mutual funds and other financial instruments:** Mutual funds and other financial instruments can be an important source of retirement income in India. Individuals can invest in mutual funds, stocks, bonds, and other financial instruments to save for retirement.

7. **Financial advisors:** Financial advisors can provide guidance and advice on retirement planning in India, including creating a retirement savings plan, selecting appropriate investments, and developing a retirement income strategy.

11.9 DEVELOPMENT OF RETIREMENT PLANS

Developing a retirement plan involves several key steps:

i. **Set Your Retirement Goals:** Determine your desired retirement lifestyle, including where you want to live, travel plans, and any specific activities you want to pursue during retirement.

ii. **Calculate Retirement Expenses:** Estimate your future expenses, including housing, healthcare, daily living costs, travel, and any hobbies or interests.

iii. **Assess Your Current Financial Situation:** Take stock of your current savings, investments, assets, and debts. Consider any pension or Social Security benefits you may be eligible for.

iv. **Determine Your Retirement Age:** Decide when you want to retire, as this will impact the duration of your savings and the amount you'll need.

v. **Create a Budget:** Establish a budget that includes saving for retirement while also managing your day-to-day finances.

vi. **Choose Retirement Accounts:** Select the right retirement accounts, such as 401(k)s, IRAs, or other investment vehicles that align with your financial goals and risk tolerance.

vii. **Investment Strategy:** Develop an investment strategy based on your risk tolerance and timeline. Diversify your investments to spread risk.

viii. **Regular Monitoring:** Periodically review your plan and make adjustments as needed to stay on track with your savings and investment goals.

ix. **Healthcare Considerations:** Account for healthcare costs in retirement, including insurance and potential long-term care needs.

x. **Estate Planning:** Create or update your will and consider how your assets will be distributed to ensure your financial legacy is handled as you wish.

xi. **Seek Professional Advice:** Consult with a financial advisor or retirement specialist to receive expert guidance tailored to your specific situation.

Remember that a well-rounded retirement plan should be adaptable to life changes and economic fluctuations. Start early, save consistently, and seek professional advice to maximize the chances of achieving your retirement goals.

11.10 SUMMARY

Retirement needs analysis refers to the process of evaluating an individual's financial situation, goals, and lifestyle to determine how much money they will need to maintain their desired standard of living during retirement. It involves assessing various factors, such as current savings, expected expenses, inflation, and investment returns, to create a plan that ensures a financially secure retirement. This analysis helps people make informed decisions about savings, investments, and retirement contributions to meet their future financial requirements. Certainly, retirement need analysis is an essential step in financial planning.

11.11 GLOSSARY

i. **Retirement needs analysis:** Retirement needs analysis refers to the process of evaluating an individual's financial situation, goals, and lifestyle to determine how much money they will need to maintain their desired standard of living during retirement.

ii. **Employee Provident Fund (EPF):** The majority of employees in India are required to participate in the government-sponsored EPF retirement scheme. Both employers and employees make contributions to the retirement fund, which is accessible upon retirement.

iii. **National Pension System (NPS):** All Indian nationals are eligible for the government- sponsored NPS retirement programme. The NPS accepts

contributions from individuals, and the money is invested in a combination of government securities, debt, and equity.

11.12 SELF-ASSESSMENT QUESTIONS

1. Discuss the concept and techniques of retirement need analysis.

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2. Explain the process of and sources of retirement planning.

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11.13 SUGGESTED READING

- Retirement Planning by R K Mohapatra
- Personal Finance by Jeff Madura

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UNIT-III LESSON NO. 12

RETIREMENT PLANNING AND EMPLOYEE BENEFITS

RETIREMENT BENEFITS, EPF, PPF

STRUCTURE

12.1 Introduction

12.2 Objectives

12.3 Retirement Schemes

12.4 Employees Provident Fund (EPF)

12.5 Key Features of EPF Scheme

12.6 Benefits of the EPF

12.7 Types of Employees' Provident Fund

12.7.1 Tax Treatment of Contribution to different Category of Provident Fund

12.8 Public Provident Fund

12.9 Benefits of PPF

12.10 Summary

12.11 Glossary

12.12 Self-Assessment Questions

12.13 Suggested Reading

12.1 INTRODUCTION

Retirement scheme means agreements or arrangements (whether legally enforceable or not) for the payment of any pensions, allowances, lump sums or other like benefits on retirement or on death or during periods of sickness or disablement for the bene fit of any present or former director, officer or employee of any Group Company or for the benefit of the dependants of any such persons. The Employees' Provident Fund (EPF) is a government-backed retirement savings scheme that is mandatory for most employees in India. Under the EPF scheme, both the employee and employer contribute a fixed percentage of the employee's salary (12% of the basic salary plus dearness allowance) to the EPF account. The employee can withdraw the accumulated amount in the EPF account at the time of retirement or resignation. Employees' Provident Fund Organisation (EPFO) was established by an act of Parliament of India, to provide social security to workers working in India. It came into force by Employee Provident Fund and Miscellaneous Provision Act, 1952. EPFO comes under the control of the Ministry of Labour and Employment, Government of India.

12.2 OBJECTIVES

After reading the lesson, the student will help you to assess:

- Retirement schemes
- Employees Provident Fund (EPF)
- Key Features of EPF Scheme
- Benefits of the EPF
- Types of Employees' Provident Fund
- Tax Treatment of Contribution to different Category of Provident Fund
- Benefits of PPF

12.3 RETIREMENT SCHEMES

Retirement scheme means agreements or arrangements (whether legally enforceable or not) for the payment of any pensions, allowances, lump sums or

other like benefits on retirement or on death or during periods of sickness or disablement for the bene fit of any present or former director, officer or employee of any Group Company or for the benefit of the dependants of any such persons.

12.4 EMPLOYEES PROVIDENT FUND (EPF)

The Employees' Provident Fund (EPF) is a government-backed retirement savings scheme that is mandatory for most employees in India. Under the EPF scheme, both the employee and employer contribute a fixed percentage of the employee's salary (12% of the basic salary plus dearness allowance) to the EPF account. The employee can withdraw the accumulated amount in the EPF account at the time of retirement or resignation. Employees' Provident Fund Organisation (EPFO) was established by an act of Parliament of India, to provide social security to workers working in India. It came into force by Employee Provident Fund and Miscellaneous Provision Act, 1952. EPFO comes under the control of the Ministry of Labour and Employment, Government of India.

There are 3 major schemes of EPFO:

1. EPFO Scheme 1952

Salient features of EPFO schemes

1. Accumulation plus interest upon retirement and death
2. Partial withdrawals allowed for education, marriage, illness and house construction
3. Housing scheme for EPFO members to achieve the Prime Minister's vision of Housing for all by 2022.

2. Pension Scheme 1995 (EPS)

Salient features of the Pension Scheme

1. The monthly benefit for superannuation/benefit, disability, survivor, widow(er) and children
2. Minimum pension of disablement

3. Past service benefit to participants of the erstwhile Family Pension Scheme, 1971.

3. Insurance Scheme 1976 (EDLI)

Salient features of the scheme

1. The benefit provided in case of the death of an employee who was a member of the scheme at the time of death.

2. Benefit amount 20 times the wages, maximum benefit of 6 Lakh.

EPFO is the largest social security organization in the world in terms of the number of covered beneficiaries and the largest in terms of the volume of financial transactions undertaken. On 1st October 2014, Prime Minister launched Universal Account Number for Employees covered by EPFO to enable PF number portability. The Act, which covers all of India, is currently known as the Employees' Provident Funds & Miscellaneous Provisions Act, 1952. The Central Board of Trustees, Employees' Provident Fund, a tri-partite board made up of members of the government (both central and state), employers, and employees, is responsible for overseeing the Act and the Schemes created under it.

12.5 KEY FEATURES OF EPF SCHEME

The Employees Provident Scheme (EPS) is a government- mandated savings scheme that provides retirement benefits to employees in India. Here are some key features of the Employees Provident Scheme:

1. **Eligibility:** The scheme is applicable to all employees who are members of the Employees' Provident Fund (EPF).

2. **Contributions:** Both the employee and employer contribute 12% of the employee's basic salary and dearness allowance to the EPF. Out of this, 8.33% is diverted to the EPS, subject to a maximum of Rs. 1250 per month.

3. **Pension benefits:** The scheme provides a pension to employees after they retire or in the event of their death. The pension amount is

based on the employee's length of service and their contribution to the scheme.

4. **Withdrawal:** Employees can withdraw their EPS contributions after 10 years of service, or in the event of disability, resignation, or death.

5. **Nomination:** Employees can nominate their spouse or children as beneficiaries in the event of their death.

6. **Interest rate:** The EPS currently offers an interest rate of 8.15% per annum.

7. **Tax benefits:** Contributions to the EPS are eligible for tax deductions under Section 80C of the Income Tax Act, 1961. Overall, the Employees Provident Scheme provides a reliable retirement benefit to employees, helping them to secure their financial future.

12.6 BENEFITS OF THE EPF

The Employees' Provident Fund (EPF) scheme in India has several benefits for both employees and employers. Here are some of the key benefits of the EPF scheme:

1. **Retirement savings:** The EPF scheme helps employees save for their retirement. The funds accumulated in the EPF account can provide a steady source of income in retirement.

2. **Tax benefits:** Contributions made to the EPF account are taxdeductible under Section 80C of the Income Tax Act, up to a maximum of Rs. 1.5 lakh per year. Additionally, the interest earned on the EPF account is tax-free.

3. **Social security:** The EPF scheme provides social security to employees, ensuring that they have a financial cushion in case of unemployment, disability, or other unforeseen circumstances.

4. **Low risk:** The EPF scheme is a low-risk investment option as the funds are managed by the government and invested in fixed income securities such as bonds and debentures.

5. **Competitive interest rate:** The EPF scheme offers a competitive interest rate on the accumulated funds. The interest rate is determined by the government of India every year based on the prevailing economic conditions.

6. **Employer contribution:** Employers are required to contribute an equal amount to the EPF account as the employee. This provides an additional source of retirement savings for employees.

7. **Easy withdrawal:** Employees can withdraw the accumulated amount in the EPF account at the time of retirement or resignation. This makes it easy for employees to access their retirement savings when they need it.

8. **Portability:** The EPF account is portable, which means that employees can transfer their account from one employer to another. This ensures that their retirement savings are not impacted by changes in employment.

12.7 TYPES OF EMPLOYEES' PROVIDENT FUND

1. Recognized Provident Fund

All establishments with 20 or more employees are subject to the Provident Fund Act of 1952. The establishments covered by the scheme have the option of applying for the government-approved scheme or founding their own Provident Fund trust. The establishments can join the PF (Provident Fund) Act 1952, which is a recognized provident fund, which is a government-approved system. Alternatively, the employer and employee of the organization may form a trust to establish a provident fund scheme, with funds invested in accordance with the Provident Fund (PF) Act of 1952. Before it can be labeled as a recognized provident fund, the scheme must be approved by the commissioner of income tax.

2. PPF (Public Provident Fund)

For the general population, the government has established a provident fund. By creating a public provident fund account with an authorised

bank, anyone can contribute to this scheme. Amounts ranging from INR 500 to INR 1,50,000 can be deposited. Following the completion of 15 years, the PPF (Public Provident Fund) corpus can be entirely withdrawn.

3. Statutory Provident Fund

The Provident Funds Act of 1925 established this plan. It is intended for government employees, accredited educational institutions, railways, universities, and other similar organizations. The General Provident Fund is another name for Statutory Provident Fund. The government adjusts the interest rates on General Provident Funds on a regular basis. Employees in the private sector are not covered by the General Provident Fund (GPF).

4. Unrecognized Provident Fund

If the commissioner of income tax does not approve the provident fund program established by the employer and employee (as described in Recognized Provident Fund), the scheme is considered unrecognized.

12.7.1 Tax Treatment of Contribution to different Category of Provident Fund

1. Tax on Recognized Provident Fund

When an employer's contribution to a provident fund reaches 12 percent, it is taxed. The employee's contribution to the provident fund is taxed.

Tax will be deducted if the rate of interest credited to the provident fund is greater than 9.5 percent. The retirement payment is tax-free if the following conditions are met:

- If the employer-provided 5 years or more of continuous service.
- If the employee was fired for a variety of reasons, including health concerns, the employer's decision to stop doing business, and so forth.
- If an employee resigns and then returns to work for another company.
- If the employee's complete credit balance is transferred to his or her account under a pension system under section 80CCD.

2. **Tax on PPF (Public Provident Fund)**

The contribution of an employer to a provident fund is taxed. The interest and retirement payments credited to the provident fund are tax-free.

3. **Tax on Statutory Provident Fund**

The employer's contribution to the provident fund is tax-free, while the employee's contribution is taxed. Tax-free interest and retirement payments are credited to the provident fund.

4. **Tax on Unrecognised Provident Fund**

Employer contributions to a provident fund are tax-deductible. Under the following circumstances, the retirement payment is taxable:

- Under the heading salaries, payments received in respect of the employer's contribution and interest are taxed.
- Payments received in exchange for interest on an employee's contribution are taxable as income from other sources.
- Payments received in exchange for an employee's contribution are not taxed.

12.8 PUBLIC PROVIDENT FUND (PPF)

In India, the Public Provident Fund (PPF) is a long-term savings programme backed by the government that provides enticing interest rates and tax advantages. All Indian citizens are eligible to open PPF accounts, which can be done at authorised post offices, nationalised banks, and select private banks. The scheme has a tenure of 15 years and can be extended for another 5 years.

Here are some key features of the PPF scheme:

1. **Investment amount:** The minimum investment amount in a PPF account is Rs. 500 per year, while the maximum is Rs. 1.5 lakh per year.
2. **Interest rate:** The interest rate on PPF is set by the government of India and is subject to change every quarter. For the April-June 2022 quarter, the interest rate is 7.1%.

3. **Tax benefits:** Contributions made to the PPF account are taxdeductible under Section 80C of the Income Tax Act, up to a maximum of Rs. 1.5 lakh per year. Additionally, the interest earned on the PPF account is tax-free.

4. **Lock-in period:** The PPF account has a lock-in period of 15 years, after which the account holder can either withdraw the entire amount or extend the account for a further period of 5 years.

5. **Loan facility:** After completing 3 years of the PPF account tenure, account holders can avail of a loan against the balance in the account.

6. **Partial withdrawal:** Account holders can make partial withdrawals from the PPF account after completing 5 years from the end of the financial year in which the account was opened.

7. **Nomination facility:** PPF account holders can nominate a nominee who will receive the funds in case of the account holder's death.

All things considered, the PPF scheme is a secure and alluring long-term investment choice that offers tax advantages and steady profits. It is the best choice for people who want to put money aside for long-term objectives including retirement planning, paying for their children's education, and other significant expenses.

12.9 BENEFITS OF PPF

Public Provident Fund, also known as PPF, is a long-term savings programme introduced by the Indian government. It is a popular investment choice among people because it provides investors with a number of advantages. The following are a few advantages of PPF:

1. **Tax benefits:** Under Section 80C of the Income Tax Act, 1961, contributions made to PPF are eligible for tax deductions. Both the accrued interest and the maturity revenues are tax-free.

2. **Guaranteed returns:** The current annual rate of return offered by PPF is 7.1 percent and is fixed and guaranteed. The government evaluates and updates this rate every three months.

3. **Long-term investment:** PPF has a 15-year term that can be extended for another 5 years. It is an enormous alternative for those who want to make long-term investments.

4. **Flexibility:** PPF offers flexibility in terms of investment amount. An individual can invest a minimum of Rs. 500 and a maximum of Rs. 1.5 lakh in a financial year. They can also make partial withdrawals after the fifth year.

5. **Safety:** PPF is a safe investment option as it is backed by the government. It offers guaranteed returns, making it a low-risk investment option.

6. **Compound interest:** PPF offers compound interest, which means interest earned in a year is added to the principal amount, and interest is calculated on the new amount. This helps in generating higher returns.

7. **Loan facility:** PPF offers a loan facility to account holders after the third year of opening the account. The loan amount can be up to 25% of the balance in the account at the end of the second year preceding the year in which the loan is applied for.

8. **Estate planning:** PPF also offers estate planning benefits as the account holder can nominate a nominee. In the event of the account holder's death, the nominee can receive the maturity proceeds or continue with the account until maturity.

12.10 SUMMARY

The Employees' Provident Fund (EPF) is a government-backed retirement savings scheme that is mandatory for most employees in India. Under the EPF scheme, both the employee and employer contribute a fixed percentage of the employee's salary (12% of the basic salary plus dearness allowance) to the EPF account. The employee can withdraw the accumulated amount in the EPF account at the time of retirement or resignation. Employees' Provident Fund Organisation (EPFO) was established by an act of Parliament of India, to provide social security to workers working in India. It came into force by Employee Provident Fund and Miscellaneous Provision Act, 1952. EPFO comes

under the control of the Ministry of Labour and Employment, Government of India.

12.11 GLOSSARY

1. **Recognized Provident Fund :** All establishments with 20 or more employees are subject to the Provident Fund Act of 1952. The establishments covered by the scheme have the option of applying for the government-approved scheme or founding their own Provident Fund trust.
2. **PPF (Public Provident Fund) :** For the general population, the government has established a provident fund. By creating a public provident fund account with an authorised bank, anyone can contribute to this scheme. Amounts ranging from INR 500 to INR 1,50,000 can be deposited.
3. **Statutory Provident Fund :** The Provident Funds Act of 1925 established this plan. It is intended for government employees, accredited educational institutions, railways, universities, and other similar organizations.
4. **Unrecognized Provident Fund :** If the commissioner of income tax does not approve the provident fund program established by the employer and employee (as described in Recognized Provident Fund), the scheme is considered unrecognized.

12.11 SELF-ASSESSMENT QUESTIONS

1. Discuss the various retirement schemes available in India.

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2. Explain tax treatment of contribution to different categories of provident fund.

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12.13 SUGGESTED READING

- Retirement Planning for Youth: With New pension Scheme (English, Paperback, PROF. KSHITIJ PATUKALE)
- Retirement Planning by R K Mohapatra
- Personal Finance by Jeff Madura

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UNIT-III LESSON NO. 13

RETIREMENT PLANNING AND EMPLOYEE BENEFITS

SUPERANNUATION FUNDS

STRUCTURE

13.1 Introduction

13.2 Objectives

13.2 Superannuation Fund

13.4 Key features of Superannuation Funds in India

13.5 Types of Superannuation benefit

13.6 How does superannuation work?

13.7 Benefits of Superannuation Funds

13.8 Taxation of Superannuation Fund

13.9 Exemption of Superannuation Fund

13.10 Summary

13.11 Glossary

13.12 Self-Assessment Questions

13.13 Suggested Reading

13.1 INTRODUCTION

Superannuation Fund: Superannuation funds, like Provident Funds, are a type of retirement benefit plan for employees. These are funds, typically

established under trusts by an undertaking, for the purpose of providing annuities, etc., to the undertaking's employees upon retirement at or after a specified age, or upon becoming incapacitated prior to such retirement, or for the employees' widows, children, or dependents in the event of any employee's earlier death. The trust invests the funds' contributions in the manner and form prescribed. Income from these investments is exempt if the fund is an Approved Superannuation Fund.

13.2 OBJECTIVES

After reading the lesson, the student will help you to assess:

- Superannuation Fund
- Key features of Superannuation Funds in India
- Types of Superannuation benefit
- How does superannuation work?
- Benefits of Superannuation Funds
- Taxation of Superannuation Fund
- Exemption of Superannuation Fund

13.3 SUPERANNUATION FUND

Superannuation funds, like Provident Funds, are a type of retirement benefit plan for employees. These are funds, typically established under trusts by an undertaking, for the purpose of providing annuities, etc., to the undertaking's employees upon retirement at or after a specified age, or upon becoming incapacitated prior to such retirement, or for the employees' widows, children, or dependents in the event of any employee's earlier death. The trust invests the funds' contributions in the manner and form prescribed. Income from these investments is exempt if the fund is an Approved Superannuation Fund.

13.4 KEY FEATURES OF SUPERANNUATION FUNDS IN INDIA

1. **Employer-sponsored:** Employers sponsor superannuation funds and contribute a specific portion of the employee's base pay to the fund.
2. **Voluntary participation:** Employees may choose to opt out of the plan at any time. Employees may choose to participate in the plan at their own discretion.
3. **Long-term investment:** The Superannuation Fund contributions are placed in long-term investments with the intention of earning a return over time.
4. **Tax advantages:** Under Section 80C of the Income Tax Act of 1961, contributions made to the Superannuation Fund are eligible for tax deductions. Both the accrued interest and the maturity revenues are tax-free.
5. **Vesting term:** After a vesting period, which is typically five years, the employee is qualified to receive Superannuation Fund benefits.
6. **Retirement benefits:** After an employee retires, the Superannuation Fund offers retirement benefits in the form of a lump sum payout or a monthly pension.
7. **Options for withdrawal:** Employees have the choice of receiving their whole accrued money as one lump sum payment or a monthly pension distribution.
8. **Estate Planning:** The Superannuation Fund provides estate planning advantages by allowing employees to name a nominee to receive benefits in the case of their death. In general, Superannuation Funds give employees a dependable retirement benefit, assisting them in securing their financial future.

13.5 TYPES OF SUPERANNUATION BENEFIT

Based on the investments and benefits it provides, superannuation benefits in India are divided into the following categories:

1. **Defined benefit plans:** As the name implies, regardless of contributions made to the plan, the benefit received under this type of superannuation is already fixed. The pre-determined benefit is dependent on a variety of variables, including the number of years of employment with the company, pay, and the age at which the person begins receiving the benefit. This is somewhat complicated, and the employer bears the risk of producing such a benefit. An eligible employee who retires will receive a fixed sum, established by the pre-existing formula, at regular intervals.
2. **Defined contribution plans:** The defined benefit plan is the reverse of this superannuation benefit. A defined contribution plan has a fixed contribution and a benefit that is directly associated with the contribution and market forces, whereas a defined benefit plan has a fixed contribution and a benefit that is fixed and predetermined. As the employee has no idea how much he will earn in retirement, this sort of benefit is easier to handle.

13.6 HOW DOES SUPERANNUATION WORK?

The employer makes a contribution to the group superannuation policy he owns on behalf of the employees as a superannuation benefit. Organizations either manage their own superannuation trusts, open a superannuation benefit fund with any of the authorised insurance companies, or purchase the product from insurance companies like LIC's New Group Superannuation Cash Accumulation Plan or ICICI's Endowment superannuation plans etc., among others. The company must contribute a defined percentage of each employee's base salary and dearness allowance (up to a maximum of 15%), and this percentage must be the same for each group of employees. Although the employer contributes, superannuation should ideally be included in the cost to the company (CTC).It should be emphasised that, in the case of defined

contribution plans, employees may also choose to voluntarily contribute additional funds. The employee may withdraw up to one-third of the accrued benefit at retirement and convert the remaining portion into a regular pension. The remaining portion is then held in the annuity fund to receive annuity returns at predetermined intervals. The employee has the option to transfer the superannuation amount to a new employer in the event that he switches jobs. If the new employer does not offer a superannuation plan, the employee has two options: remove the money now or wait until retirement to take it out as previously described.

13.7 BENEFITS OF SUPERANNUATION FUNDS

Superannuation Funds are a well-liked retirement benefit programme in India since they provide numerous advantages to employees. Here are a few of the main advantages of superannuation funds:

1. **Employer-sponsored:** Employers sponsor superannuation funds and contribute a specific portion of the employee's base pay to the fund. This guarantees that workers can save for their golden years without facing further financial hardship.

2. **Tax benefits:** Under Section 80C of the Income Tax Act of 1961, contributions made to the Superannuation Fund are eligible for tax deductions. Both the accrued interest and the maturity revenues are tax-free.

3. **Long-term investment:** The Superannuation Fund's contributions are invested for the long term with the intention of earning a return on investment over time. This guarantees that the workers will receive a significant retirement benefit.

4. **Vesting period:** After a vesting period, which is typically five years, the employee is qualified to collect the Superannuation Fund's benefits. The long-term investment of the staff is ensured by doing this.

5. **Retirement benefits:** After an employee retires, the Superannuation Fund offers retirement benefits in the form of a lump sum payout or a

monthly pension. This helps workers in continuing to live comfortably after retirement.

6. **Withdrawal options:** Either a lump sum withdrawal of the total accrued cash or a monthly pension payment is an option for the employees. In terms of withdrawal possibilities, this gives the employees flexibility.

7. **Estate planning:** The Superannuation Fund has an estate planning feature that allows employees to name a beneficiary to receive benefits in the case of their death. This makes sure that even when the employee passes away, their family will be taken care of.

   Overall, Superannuation Funds provide a secure and reliable retirement benefit to employees, helping them to secure their financial future.

13.8 TAXATION OF SUPERANNUATION FUND

Like any other retirement benefit, superannuation benefit also provides income tax benefits to both employer and employee. However, such benefits are restricted to an approved superannuation fund. This approval is required to be obtained from the Commissioner of Income Tax in accordance with the rules set out in Part B of the Fourth Schedule of the IT Act.

For the Employer

Contribution to approved (by income tax department) superannuation fund is deductible business expense and any income received by self-managed trusts of an approved superannuation fund is also exempt.

For the Employee

- Employee's contribution to the approved superannuation fund is deductible under Section 80C subject to overall limit of Rs 1,50,000.
- Amount withdrawn if any by the employee at the time of change of job is taxable under the head "Income from other sources"
- Any benefit received from superannuation fund on death or injury are tax free

- Interest from a superannuation fund is tax free
- On retirement, 1/3 of the commuted fund is fully exempt from tax and the remaining amount if transferred to an annuity is tax-free and if the amount is withdrawn, it is taxable in the hands of the employee.
- Employer's contribution of up to Rs 1.5 lakh in respect of an employee is exempt. However, if the contribution exceeds Rs 1.5 lakh, the amount in excess will be taxable in the hands of the employee as a perquisite.

13.9 EXEMPTION OF SUPERANNUATION FUND

Any payment from an approved superannuation fund, made under following circumstances, shall be exempt

1. The payment was made upon the beneficiary's death; or
2. The payment was made upon the beneficiary's death as a refund of contributions; or
3. The payment has been made to the employee's account via transfer under the pension scheme referred to in section 80CCD and notified by the Central Government; or
4. The payment was made to an employee in lieu of or in commutation of an annuity upon his retirement, at or after a specified age, or upon his becoming incapable prior to retirement; or
5. The payment was made in the form of a contribution refund to an employee upon leaving the service (for which the fund was established) at or after a specified age or upon the employee becoming incapable prior to retirement.

13.10 SUMMARY

Superannuation funds, like Provident Funds, are a type of retirement benefit plan for employees. These are funds, typically established under trusts by an undertaking, for the purpose of providing annuities, etc., to the undertaking's employees upon retirement at or after a specified age, or upon

becoming incapacitated prior to such retirement, or for the employees' widows, children, or dependents in the event of any employee's earlier death. The trust invests the funds' contributions in the manner and form prescribed. Income from these investments is exempt if the fund is an Approved Superannuation Fund.

13.11 GLOSSARY

1. **Defined benefit plans:** As the name implies, regardless of contributions made to the plan, the benefit received under this type of superannuation is already fixed. The pre-determined benefit is dependent on a variety of variables, including the number of years of employment with the company, pay, and the age at which the person begins receiving the benefit.

2. **Defined contribution plans:** The defined benefit plan is the reverse of this superannuation benefit. A defined contribution plan has a fixed contribution and a benefit that is directly associated with the contribution and market forces, whereas a defined benefit plan has a fixed contribution and a benefit that is fixed and predetermined.

13.12 SELF-ASSESSMENT QUESTIONS

1. Discuss the working of superannuation fund.

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2. Explain tax treatment and exemption of superannuation fund.

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13.13 SUGGESTED READING

- Retirement Planning for Youth: With New pension Scheme (English, Paperback, Prof. Kshitij Patukale)
- Retirement Planning by R K Mohapatra
- Personal Finance by Jeff Madura

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UNIT-III LESSON NO. 11

RETIREMENT PLANNING AND EMPLOYEE BENEFITS

GRATUTITY, PENSION REFORMS IN INDIA RETIREMENT PRODUCT AVAILABLE IN THE MARKET

STRUCTURE

14.1 Introduction

14.2 Objectives

14.3 Gratuity

14.4 Needs for Gratuity

14.5 Key features of Gratuity

14.6 Key Benefits of gratuity

14.7 Eligibility Criteria for Payment of Gratuity

14.8 Taxability of gratuity

14.9 Retirement product available in the market

14.10 Pension Reforms in India

14.11 Summary

14.12 Glossary

14.12 Self-Assessment Questions

14.13 Suggested Reading

14.1 INTRODUCTION

A gratuity is the sum of money that an employer gives to a worker in appreciation for the services that the worker has provided to the business. The gratuity sum, however, is only granted to employees who have worked for the business for five years or longer. It is governed by the Payment of Gratuity Act, 1972. If an employee becomes handicapped in an accident or due to a disease, they are eligible to receive their gratuity before the five-year mark. The amount of your gratuity is primarily based on your most recent income and the number of years you have worked for the company. As per the Payment of Gratuity Act, 1972, an employee is eligible for gratuity if he/she has completed five years of continuous service with the same employer. Gratuity is payable on retirement, resignation, superannuation, death, or disablement due to accident or illness.

14.2 OBJECTIVES

After reading the lesson, the student will help you to assess:

- Gratuity
- Needs for Gratuity
- Key features of Gratuity
- Key Benefits of gratuity
- Eligibility Criteria for Payment of Gratuity
- Taxability of gratuity
- Retirement product available in the market
- Pension Reforms in India

14.3 GRATUITY

A gratuity is the sum of money that an employer gives to a worker in appreciation for the services that the worker has provided to the business. The gratuity sum, however, is only granted to employees who have worked for the business for five years or longer. It is governed by the Payment of Gratuity

Act, 1972. If an employee becomes handicapped in an accident or due to a disease, they are eligible to receive their gratuity before the five-year mark. The amount of your gratuity is primarily based on your most recent income and the number of years you have worked for the company.

14.4 NEEDS FOR GRATUITY

As per the Payment of Gratuity Act, 1972, an employee is eligible for gratuity if he/she has completed five years of continuous service with the same employer. Gratuity is payable on retirement, resignation, superannuation, death, or disablement due to accident or illness.

14.5 KEY FEATURES OF GRATUITY

The key features of gratuity are as follows:

1. **Eligibility:** An employee is eligible for gratuity if he/she has completed five years of continuous service with the same employer.
2. **Calculation of Gratuity:** The amount of gratuity payable to an employee is calculated based on the employee's last drawn salary and the number of years of service completed.
3. **Maximum Amount:** The maximum amount of gratuity payable under the Payment of Gratuity Act, 1972 is Rs. 20 lakhs. However, an employer may choose to pay a higher amount if they wish to do so.
4. **Payment of Gratuity:** Gratuity is payable to an employee on retirement, resignation, superannuation, death, or disablement due to accident or illness.
5. **Tax Implications:** Gratuity is exempt from income tax up to a certain limit, which is currently Rs. 20 lakhs. Any amount of gratuity received over and above this limit is taxable.
6. **Nomination:** An employee can nominate one or more persons to receive the gratuity in case of their death.
7. **Insurance Coverage:** An employer may choose to take out a group

gratuity insurance policy to cover the liability of payment of gratuity to employees.

Overall, gratuity is an important employee benefit that provides financial security to employees and recognizes their contributions to the organization. The key features of gratuity ensure that it is paid in a fair and transparent manner, and provide safeguards to both employees and employers.

14.6 KEY BENEFITS OF GRATUITY IN ARE AS FOLLOWS:

1. **Retirement Benefits:** Employees receive a financial cushion when they retire from their job after completing the required years of service. This allows them to live comfortably in their retirement years.
2. **Employee Retention:** Gratuity encourages employees to stay with the same employer for a longer period of time by ensuring that they will be rewarded for their loyalty and hard work.
3. **Financial Security:** In the event of an employee's death or disability, gratuity provides financial support to their family members and dependents. This ensures that they can maintain their standard of living even if the earning member is not present.
4. **Statutory Obligation:** Employers in India are required by law to give their employees who have completed five years of continuous service a gratuity. Failure to do so may result in legal action being taken against the employer.
5. **Boosts Employee Morale:** The payment of a gratuity boosts employee morale by recognising their contributions to the organisation and providing them with a sense of financial security. This, in turn, can lead to increased productivity and loyalty to the organisation.

Overall, gratuity is an important component of the employee benefit package in India, providing employees with financial security as well as a sense of appreciation for their hard work and dedication.

14.7 ELIGIBILITY CRITERIA FOR PAYMENT OF GRATUITY

To receive the gratuity, you must meet the following eligibility criteria:

- Employees should be qualified for retirement benefits.
- Employee should have ended their employment.
- After five years of continuous employment with the organisation, the employee should have resigned.
- The gratuity is provided to the nominee in cases of employee death or to you if you become disabled due to illness or an accident.

14.8 TAXABILITY OF GRATUITY

If any employee receives gratuity during his service, then it is fully taxable as income in his hands under the Income Tax Act, 1961 ('the Act'). However, if gratuity is received in case of death, retirement or resignation and certain other cases, then tax exemption is provided under section 10(10) of the Act.

Any amount received as a gratuity by an employee shall be treated as income of such person under the head 'Salaries'. However, in case of the death of such an employee, the gratuity shall be paid to his nominee or his legal heir as the case may be. Such an amount shall be treated as their income under the head 'income from other sources'.

Note: Every employee is compulsorily required to prescribe the name/s of their nominee after completing a year of service as per the Payment of Gratuity Act, 1972.

Payment of Gratuity in case of Death of the Employee

In the unfortunate event of the death of an employee, gratuity is still payable, even if the employee has not completed the minimum 5 years of continuous service required for normal gratuity eligibility. The Payment of Gratuity Act, 1972, makes provisions for gratuity payment in case of death or disability of an employee.

Here are the key points regarding the payment of gratuity in the event of the death of an employee:

- **Minimum Service Requirement:** If the employee has completed a minimum of one year of continuous service with the employer, gratuity becomes payable in the event of the employee's death.
- **Nominee or Legal Heir:** The gratuity amount is usually paid to the nominee appointed by the deceased employee. In the absence of a nominee, it is paid to the legal heirs of the deceased.
- **Gratuity Calculation:** The gratuity amount payable in case of the employee's death is calculated based on the completed years of service up to the date of death.for the purpose of calculation any part of year in excess of six months is considered as one year.
- **Calculation Formula:** The formula for calculating gratuity in this case is: (Last drawn salary × 15 days × completed years of service) / 26.
- **Tax Implications:** The gratuity amount received by the nominee or legal heir is exempt from income tax up to a maximum limit specified by the government. Any amount exceeding the exempted limit may be taxable.
- **Prompt Payment:** Employers are legally required to make the gratuity payment within 30 days from the date it becomes payable, i.e., the date of the employee's death.

Income tax exemption on gratuity

The tax exemption on gratuity income provided under section 10(10) of the Act is available up to the following limits:

- Retirement gratuity received by members of the Defence Service under the Pension Code Regulations, is entirely exempt from tax.
- Employees of Central and State Government/local authority or Members of Civil Services: Any death cum retirement gratuity is entirely exempt from tax under section 10(10)(i).

- **Other employees:**

i. Private sector employees covered by the Payment of Gratuity Act, 1972

The Payment of Gratuity Act, 1972 prescribes gratuity for employees of certain organizations. The employees of the following organizations are entitled to gratuity:

- Factory, plantation, mine, oilfield, port and railway company
- Shops, establishments or educational institutions having ten or more employees on any day during the preceding twelve months

Any death and retirement gratuity is exempt from tax to the extent of the least of the following: (a) Rs. 20 lakhs (hiked from Rs. 10 Lakh as per the amendment)

- Actual gratuity amount received
- Total salary amount should be a sum of 15 days of services for every completed year or part thereof in excess of six month.i.e. 15/26.

Points to be note:

- Once the Act becomes applicable to an organization, gratuity shall continue to be applicable for it even if the employees' count falls below ten.
- The service duration is approximated to the nearest full year.

**Salary for this section means basic salary and dearness allowance (if it is given in the terms of employment for retirement benefits that form part of salary)

ii. Private sector employees not covered by the Payment of Gratuity Act, 1972:

The Payment of Gratuity Act, 1972 mandates certain organisations to make gratuity payments. However, other organisations are free to

make a voluntary payment of gratuity to their employees. There are no restrictions on making such payments of gratuity.

Tax exemption limit for such employees is the least of the following:

A. Rs.10 lakhs

- Actual gratuity amount received
- The formula: 1/2x(last 10 months average salary)/10 x number of years of employment Note: The service duration is approximated to the nearest full year.

14.9 RETIREMENT PRODUCT AVAILABLE IN THE MARKET

There are various retirement products available in the market to help individuals save and invest for their retirement. Some common options include:

i. **401(k) Plans:** Employer-sponsored retirement plans that allow you to contribute pre-tax income, often with employer matching.

ii. **Individual Retirement Accounts (IRAs):** These can be Traditional IRAs (tax-deferred) or Roth IRAs (tax-free), which individuals can open and contribute to independently.

iii. **Pension Plans:** Employer-provided plans that guarantee a specific retirement income based on years of service and salary.

iv. **Annuities:** Insurance products that provide regular payments in exchange for a lump sum or periodic contributions.

v. **Social Security:** A government program that provides retirement benefits based on your work history.

vi. **Mutual Funds:** Investment funds that pool money from multiple investors and can be used for retirement savings.

vii. **Stocks and Bonds:** Individual investments in the stock market or bonds that can be part of a retirement portfolio.

viii. **Real Estate:** Investing in properties or Real Estate Investment Trusts (REITs) for potential rental income or appreciation.

ix. **Certificates of Deposit (CDs):** Low-risk, interest-bearing savings accounts with fixed terms.

x. **Health Savings Accounts (HSAs):** Can be used for medical expenses during retirement and offer tax advantages.

xi. **Employee Stock Ownership Plans (ESOPs):** Company-sponsored plans that provide employees with ownership in the company.

xii. **Target-Date Funds:** Investment funds that automatically adjust their asset allocation based on your retirement date.

It's important to consider your financial goals, risk tolerance, and retirement timeline when choosing the right retirement products for your needs. Consulting a financial advisor can help you make informed decisions.

14.10 PENSION REFORMS IN INDIA

In India, absence of a country-wide social security system, ageing population and social change on account of breakdown of traditional family support system are important considerations for introducing pension reform in the unorganized sector. Whereas in the public sector, fiscal stress of the defined benefit pension system, applicable to the employees of the Government sector, was the major driving force for pension reforms. Since 2001- 02, a number of measures have been adopted by the Government for underlining need for pension reforms for both Central Government and for unorganized sector for different reasons. Pension Policy in India has primarily and traditionally been based on financing through employer and employee participation. As a result, the coverage has been restricted to the organized sector and a vast majority of the workforce in the unorganized sector has been denied access to formal channels of old age financial support. Only about 12 per cent of the working population in India is covered by some form of retirement benefit scheme. Besides the problem of limited coverage, the existing mandatory and voluntary private pension system is characterized by limitations like fragmented regulatory framework, lack of

individual choice and portability and lack of uniform standards. High incidence of administrative cost and low real rate of returns characterize the existing system, which has become unsustainable. Non-sustainability of the existing pension system is accentuated by the sharp increase in financial burden on the Government and the other employers on account of pension liabilities. While the total pension liability on account of the Central Government employees has increased at a compound annual growth rate of more than 21% during the 1990s, the comparable rate for the State Government was 27% per annum. Civil Servants' Pension (CSP) is a traditional defined benefit scheme which runs on the basis of pay-as-you-gosystem, for employees of Central Government who were recruited up to 31st December, 2003 and employees of State Governments recruited up to the effective date mentioned in notifications issued by those governments. CSP is an unfunded scheme and there has been no attempt at building up pension assets through contribution or any other provision. CSP scheme is indexed to wages and inflation. A modified one rank one-wage principle applies to it wherein all retired employees of a certain rank get the same pension. Pension payments are revised periodically to reflect the growth in wages and consumer price index. Growth in pension benefits in old age is typically higher than inflation. The main problem under CSP is that of fiscal stress. CSP was designed at a time when going by the pattern of life expectancy most of the employees who retired at the age of 60 were expected to live up to the age of 68 or so. The value of the annuity embedded in the CSP has gone up due to elongation of mortality in the recent years. The mortality characteristics of Government employees, who belong to the higher income group than the average, are more or less in line with the OECD populations. The fiscal stress at the sub-national level has been more acute. Some of the State governments have not made timely payment of pension benefits. One State government chose to cut benefits by reversing recent increases in the pension benefits due to hikes in the wages of existing employees. For the organized sector employees, excluding the Government employees, the basic structure of pension and other retirement benefits has been outlined in the EPF & MP Act, 1952. The provisions of this Act are applicable to all defined establishments, employing more than

20 workers and cover about 40 million employees in the organized sector. This Act remained virtually unquestioned and there were virtually no changes in the contribution, administration and benefits being provided under this Act for almost four decades. First major change occurred in 1995, with the conversion of part of defined contribution EPF Scheme to a defined benefit scheme in the form of Employees' Pension Scheme. This change in the EPF & MP Act, 1952 marked an important break from the existing policy of the Employees Provident Fund Organisation in two ways: (a) With this amendment, the concept of a mandated annuity to the employees of private sector was introduced for the first time. (b) It added a new pension liability (since the scheme is not fully funded) to the existing liability with regard to the civil servants of Central and State Governments. The EPF & MP Act, 1952 is administered by the Employees Provident Fund Organization (EPFO). At present, EPFO administers the following two old age income schemes, which are mandatory for all employees in the organized sector, earning a monthly salary of less than Rs.6,500/:- (a) The Employees Provident Fund (EPF); & (b) The Employees Pension Scheme (EPS). All the functions/ processes of EPF and EPS are handled by the EPFO, except fund management, which has been outsourced to one external agency (State Bank of India). However, some establishments, which are under the purview of EPFO are allowed to manage their own funds. EPFO treats them as exempted funds. These exempted funds are, however, required to follow the same investment pattern as being followed by EPFO and are required to match the returns of the EPFO. The Employees Provident Fund (EPF) Scheme is an individual account defined contribution scheme wherein both the employee and employer contribute to the fund at the rate of 12% of the employee's pay. There are a number of provisions under the scheme for pre- mature withdrawal of accumulation. This pre-mature withdrawal provision is frequently used by the members of the scheme which leads to small balances at the time of their superannuation. Because of low balance in individual account of the members', old age income benefit is negligible. The EPFO scheme enjoys an 'EEE' tax structure which constitutes a major tax based subsidy. The Employees Pension Scheme (EPS) is a defined benefit scheme, based on a contribution rate of

8.33% from the employee to which government makes an additional contribution of 1.16%. EPS was introduced in 1995, and is applicable to the workers who entered into employment after 1995. In case of death of a member the scheme provides for a pension to the spouse for his/her remaining life. There are other voluntary pension schemes available for general public but these schemes cover a very small segment of the total population. Life Insurance Companies and Mutual funds are offering these plans. These are essentially defined contribution schemes. Personal Pension Plans and Group Pension Products offered by the life insurers are being supervised by the Insurance Regulatory and Development Authority (IRDA). Schemes offered by the Mutual Funds are regulated/ supervised by the Security Exchange Board of India (SEBI). Tax benefits up to a specific amount are being offered to investors buying these pension plans. Total coverage under these pension plans is about 1.6 million. The other popular scheme is Public Provident Fund (PPF) which is also a defined contribution scheme. Government is managing this scheme. A fixed rate of return is offered under the scheme. In addition, tax benefits are being offered for making investment in the Public Provident Fund account. Coverage under the Public Provident Fund is about 3.5 million.

14.11 SUMMARY

A gratuity is the sum of money that an employer gives to a worker in appreciation for the services that the worker has provided to the business. The gratuity sum, however, is only granted to employees who have worked for the business for five years or longer. It is governed by the Payment of Gratuity Act, 1972. If an employee becomes handicapped in an accident or due to a disease, they are eligible to receive their gratuity before the five-year mark. The amount of your gratuity is primarily based on your most recent income and the number of years you have worked for the company. As per the Payment of Gratuity Act, 1972, an employee is eligible for gratuity if he/she has completed five years of continuous service with the same employer. Gratuity is payable on retirement, resignation, superannuation, death, or disablement due to accident or illness.

14.12 GLOSSARY

i. **Gratuity:** A gratuity is the sum of money that an employer gives to a worker in appreciation for the services that the worker has provided to the business.

ii. **Employee Stock Ownership Plans (ESOPs):** Company-sponsored plans that provide employees with ownership in the company.

iii. **Target-Date Funds:** Investment funds that automatically adjust their asset allocation based on your retirement date.

14.13 SELF-ASSESSMENT QUESTIONS

1. Discuss the benefits and eligibility criteria for payment of gratuity.

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2. Explain the various retirement products available in the market.

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14.14 SUGGESTED READING

- Retirement Planning for Youth: With New pension Scheme (English, Paperback, Prof. Kshitij Patukale)
- Retirement Planning by R K Mohaptra.
- Personal Finance by Jeff Madura.

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UNIT-III LESSON NO. 15

RETIREMENT PLANNING AND EMPLOYEE BENEFITS

OECD GUIDELINES FOR PENSION FUND GOVERNANCE

STRUCTURE

15.1 Introduction

15.2 Objectives

15.3 OECD Guidelines for Pension Fund Governance

15.4 Regulatory Framework of Retirement Plans

15.5 Regulation of Pension Sector

15.6 Pension Plans

15.7 Annuities of life insurance companies, mutual funds and Superannuation funds

15.8 How an Annuity Works

15.9 Summary

15.10 Glossary

15.11 Self-Assessment Questions

15.12 Suggested Reading

15.1 INTRODUCTION

The OECD (Organization for Economic Co-operation and Development) has established guidelines for pension fund governance to ensure the effective

management of pension funds. The regulatory framework for retirement plans can vary by country, but in the United States, it primarily falls under the jurisdiction of the Employee Retirement Income Security Act (ERISA). ERISA sets standards and rules for employer-sponsored retirement plans, such as 401(k) plans and pension plans, to protect the interests of plan participants. Key elements of the regulatory framework for retirement plans include:

15.2 OBJECTIVES

After reading the lesson, the student will help you to assess:

- OECD Guidelines for Pension Fund Governance
- Regulatory Framework of Retirement Plans
- Regulation of Pension Sector
- Pension Plans
- Annuities of life insurance companies and mutual funds
- How an Annuity Works?

15.3 OECD GUIDELINES FOR PENSION FUND GOVERANCE

The OECD (Organization for Economic Co-operation and Development) has established guidelines for pension fund governance to ensure the effective management of pension funds. Some key principles and recommendations include:

- **Regulatory Framework:** Establish a clear legal and regulatory framework for pension funds.
- **Rights of Members and Beneficiaries:** Ensure that the rights of pension fund members and beneficiaries are protected, and provide them with access to relevant information.
- **Governance Structure:** Establish a governance structure that includes boards of trustees or directors responsible for fund management.

- **Risk Management:** Implement robust risk management processes to safeguard pension assets and provide long-term financial security.
- **Investment Governance:** Develop a clear investment policy, diversify investments, and consider environmental, social, and governance (ESG) factors.
- **Transparency and Disclosure:** Provide regular, transparent, and comprehensive reporting to members and beneficiaries.
- **Internal Controls and Audit:** Maintain effective internal controls and audit procedures to ensure accountability.
- **Regulatory Oversight:** Ensure effective regulatory oversight and supervision of pension funds.

These guidelines are designed to promote good governance and help pension funds fulfill their duty to provide secure retirement benefits to their members. It's important to refer to the latest OECD publications and regulations for the most up-to-date information on pension fund governance.

15.4 REGULATORY FRAMEWORK OF RETIREMENT PLAN

The regulatory framework for retirement plans can vary by country, but in the United States, it primarily falls under the jurisdiction of the Employee Retirement Income Security Act (ERISA). ERISA sets standards and rules for employer-sponsored retirement plans, such as 401(k) plans and pension plans, to protect the interests of plan participants. Key elements of the regulatory framework for retirement plans include:

- **Fiduciary Responsibility:** Plan sponsors and administrators have a fiduciary duty to act in the best interests of plan participants, managing plan assets prudently and for their exclusive benefit.
- **Reporting and Disclosure:** ERISA requires plan sponsors to provide participants with specific information about the plan, including features, fees, and investment options.

- **Vesting and Participation:** Rules are in place to ensure that employees have the opportunity to participate in retirement plans and become vested in their accrued benefits over time.
- **Non-Discrimination:** Plans must not discriminate in favor of highly compensated employees, and there are annual contribution limits to ensure fairness.
- **Contribution Limits:** ERISA sets annual limits on the contributions that can be made to retirement plans like 401(k)s and IRAs.
- **Plan Funding:** Defined benefit pension plans are required to be adequately funded to meet future obligations to retirees.
- **Plan Termination:** Procedures for plan termination and distribution of plan assets are also regulated.

It's important to note that regulatory frameworks can change over time and may differ in other countries, so it's essential to stay informed about the specific rules and regulations governing retirement plans in your jurisdiction.

15.5 REGULATION OF PENSION SECTOR

Regulation of the pension sector is crucial to ensure the financial security of retirees and the stability of pension funds. The specifics of pension regulation can vary by country, but here are some common principles and practices:

1. **Government Oversight:** Most countries have regulatory bodies or government agencies responsible for overseeing pension funds and retirement savings programs. These agencies set rules, monitor compliance, and protect the interests of pension plan participants.
2. **Prudent Investment Guidelines:** Regulations often prescribe the types of investments pension funds can make to ensure prudent and diversified portfolios. This is done to minimize risk and protect retirees' savings.
3. **Fiduciary Duties:** Pension fund managers are typically held to a high standard of fiduciary duty, requiring them to act in the best interests of plan participants.

4. **Disclosure and Transparency:** Regulations often require pension funds to provide clear and transparent information about fees, investment performance, and the structure of the plan to help participants make informed decisions.

5. **Minimum Funding Requirements:** Many countries have rules in place to ensure that pension funds are adequately funded to meet their long-term obligations to retirees.

6. **Portability:** Regulations may address the portability of pension benefits, allowing workers to transfer their pension savings when changing employers.

7. **Social Safety Nets:** Some countries offer government-funded safety nets for retirees in addition to private pension plans to ensure a minimum level of income in retirement.

8. **Tax Incentives:** Governments may provide tax incentives to encourage individuals and employers to contribute to pension plans.

9. **Risk Management:** Regulations often require pension funds to have risk management strategies in place to mitigate potential financial downturns.

10. **Consumer Protection:** Regulations may establish mechanisms for addressing disputes and complaints, ensuring that participants have avenues to seek recourse if they feel their pension rights are not being upheld.

Pension regulations can vary significantly from one country to another, and they may evolve over time to address changing demographics and economic conditions. Staying informed about pension regulations and working with financial advisors can help individuals make the most of their retirement savings.

15.6 PENSION PLANS

Pension plans are long-term retirement savings and income programs designed to provide financial security to individuals during their retirement years. There are several types of pension plans, with the most common being:

i. **Defined Benefit Plans:** In a defined benefit plan, an employer commits to paying a specific retirement benefit to employees based on factors such as salary and years of service. The employer bears the investment and longevity risk. These plans are becoming less common in the private sector but are still prevalent in government jobs and some large corporations.

ii. **Defined Contribution Plans:** In a defined contribution plan, such as a 401(k) in the United States or a similar scheme in other countries, individuals contribute a portion of their salary to the plan, and employers may match some or all of these contributions. The retirement benefit is determined by the contributions and the investment performance of the individual's account. The individual bears the investment risk.

iii. **Hybrid Plans:** Some pension plans combine elements of both defined benefit and defined contribution plans, providing a guaranteed benefit but also allowing individuals to make contributions to their retirement accounts.

iv. **Individual Retirement Accounts (IRAs):** These are personal retirement accounts where individuals can contribute a set amount of money each year. IRAs can be either traditional (pre-tax contributions with taxable withdrawals) or Roth (after-tax contributions with tax- free withdrawals), depending on the type chosen.

v. **Public Pensions:** Government employees, such as teachers and civil servants, often have access to government-sponsored pension plans, which can resemble either defined benefit or defined contribution plans.

Pension plans are essential because they help individuals save for retirement, ensure financial security during their later years, and reduce the burden on government social safety nets. The type of pension plan and the benefits it offers can vary widely, depending on factors like the country, employer, and industry. It's important for individuals to understand the details of their pension plan, including contribution limits, vesting requirements, and the options available at retirement. Additionally, individuals often have the

flexibility to contribute to supplementary retirement savings accounts or investments to enhance their retirement income.

15.7 ANNUITIES OF LIFE INSURANCE COMPANIES, MUTUAL FUNDS AND SUPERANNUATION FUNDS

The term "annuity" refers to an insurance contract issued and distributed by financial institutions with the intention of paying out invested funds in a fixed income stream in the future. Investors invest in or purchase annuities with monthly premiums or lump-sum payments. The holding institution issues a stream of payments in the future for a specified period of time or for the remainder of the annuitant's life. Annuities are mainly used for retirement purposes and help individuals address the risk of outliving their savings. Life insurance companies and investment companies are the two primary types of financial institutions offering annuity products. For life insurance companies, annuities are a natural hedge for their insurance products. Life insurance is bought to deal with mortality risk, which is the risk of dying prematurely. Policyholders pay an annual premium to the insurance company that will pay out a lump sum upon their death. If the policyholder dies prematurely, the insurer pays out the death benefit at a net loss to the company. Actuarial science and claims experience allow these insurance companies to price their policies so that on average insurance purchasers will live long enough so that the insurer earns a profit. In many cases, the cash value inside of permanent life insurance policies can be exchanged via a 1035 exchange for an annuity product without any tax implications. Annuities, on the other hand, deal with longevity risk, or the risk of outliving one's assets. The risk to the issuer of the annuity is that annuity holders will survive to outlive their initial investment. Annuity issuers may hedge longevity risk by selling annuities to customers with a higher risk of premature death. Annuities and mutual funds are two different financial products. Annuities are insurance products that provide regular payments to an individual in exchange for a lump sum or periodic premium payments. They are often used as a retirement income source or for long-term financial planning. Annuities can offer fixed, variable, or indexed payment options. Mutual funds,

on the other hand, are investment vehicles that pool money from multiple investors to invest in a diversified portfolio of stocks, bonds, or other securities. Mutual funds do not provide guaranteed periodic payments like annuities; instead, their value fluctuates with the performance of the underlying assets. They are typically used for wealth accumulation and investment growth. While annuities and mutual funds serve different financial purposes, some investors use both in their financial planning, with annuities providing income stability and mutual funds offering the potential for capital appreciation. It's essential to understand the differences between these products and consult a financial advisor to determine how they fit into your overall financial strategy.

15.8 HOW AN ANNUITY WORKS

Annuities are designed to provide a steady cash flow for people during their retirement years and to alleviate the fears of outliving their assets. Since these assets may not be enough to sustain their standard of living, some investors may turn to an insurance company or other financial institution to purchase an annuity contract. As such, these financial products are appropriate for investors, who are referred to as annuitants, who want stable, guaranteed retirement income. Because invested cash is illiquid and subject to withdrawal penalties, it is not recommended for younger individuals or for those with liquidity needs to use this financial product. An annuity goes through several different phases and periods. These are called:

- The accumulation phase, the period of time when an annuity is being funded and before payouts begin. Any money invested in the annuity grows on a tax-deferred basis during this stage.
- The annuitization phase, which kicks in once payments commence.

These financial products can be immediate or deferred. Immediate annuities are often purchased by people of any age who have received a large lump sum of money, such as a settlement or lottery win, and who prefer to exchange it for cash flows into the future. Deferred annuities are structured to grow on a tax-deferred basis and provide annuitants with guaranteed income

that begins on a date they specify. Annuity products are regulated by the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA). Agents or brokers selling annuities need to hold a state-issued life insurance license, and also a securities license in the case of variable annuities. These agents or brokers typically earn a commission based on the notional value of the annuity contract.

15.9 SUMMARY

The OECD (Organization for Economic Co-operation and Development) has established guidelines for pension fund governance to ensure the effective management of pension funds. The regulatory framework for retirement plans can vary by country, but in the United States, it primarily falls under the jurisdiction of the Employee Retirement Income Security Act (ERISA). ERISA sets standards and rules for employer-sponsored retirement plans, such as 401(k) plans and pension plans, to protect the interests of plan participants. Key elements of the regulatory framework for retirement plans include:

15.10 GLOSSARY

- **Defined Contribution Plans:** In a defined contribution plan, such as a 401(k) in the United States or a similar scheme in other countries, individuals contribute a portion of their salary to the plan, and employers may match some or all of these contributions.
- **Hybrid Plans:** Some pension plans combine elements of both defined benefit and defined contribution plans, providing a guaranteed benefit but also allowing individuals to make contributions to their retirement accounts.
- **Individual Retirement Accounts (IRAs):** These are personal retirement accounts where individuals can contribute a set amount of money each year. IRAs can be either traditional (pre-tax contributions with taxable withdrawals) or Roth (after-tax contributions with tax-free withdrawals), depending on the type chosen.

15.11 SELF-ASSESSMENT QUESTIONS

1. Explain the OECD guidelines for pension fund governance.

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2. Briefly explain the regulatory framework of retirement plans.

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3. Critically evaluate the annuities of life insurance companies and mutual funds.

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15.12 SUGGESTED READING

- Pension Reform in India, H. Sadhak
- Personal Financial Planning by Lawrence J Gitman, Michael D Joehnk, Randall S Billingsley
- Introduction to Financial Planning by Indian Institute of Banking and Finance

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UNIT-IV LESSON NO. 16

TAX ESTATE AND ADVANCE FINANCIAL PLANNING

TAXABLE INCOME AND PRINCIPLES OF TAXATION

STRUCTURE

16.1 Introduction

16.2 Objectives

16.3 Concept of Taxation

16.4 Meaning of Taxable Income

16.5 Objectives of Taxation

16.6 Principles of Taxation

16.7 Concept of Direct Investments

16.8 Taxation of Direct Investments

16.9 Concept of Pooled Investments

16.10 Types of Pooled Investments

16.11 Taxation of Pooled Investments

16.12 Summary

16.13 Glossary

16.14 Self-Assessment Questions

16.15 Suggested Readings

16.1 INTRODUCTION

The most important source of government revenue is tax. A tax is a compulsory payment made by individuals and companies to the government on the basis of certain well established rules or criteria such as income earned, property owned, capital gains made or expenditure incurred on domestic and imported articles. In India, the person who has an income that is exceeding the minimum income as applicable under the specific income tax slab has to pay the income tax. The income tax has to be calculated based on the total income earned by a person from all sources. Tax compliance refers to policy actions and individual behaviour aimed at ensuring that taxpayers are paying the right amount of tax at the right time and securing the correct tax allowances and tax relief. Since many people object to paying taxes, taxation involves compulsion. The taxpayers are required to make certain payments, regardless of their individual wishes or desires in the matter. Because of this compulsion, the collection of taxes may have very significant effects upon the behaviour of individuals and the functioning of the economy, which must be taken into consideration in selection of taxes if the tax structure is not to interfere with the attainment of the economic goals of society. Furthermore, if the goals of society are to be realised, the burden of the taxes must be distributed among various persons in a manner consistent with these goals. No tax is ideal, but taxes are inevitable if the government is to obtain revenue to pay for its expenditure. The government tries to satisfy most taxpayers by ensuring that taxes are fair and reasonable.

16.2 OBJECTIVES

In this lesson, you will be able to understand:

- Concept of Taxation
- Principles of Taxation
- Meaning of Taxable Income
- Pooled investment

16.3 CONCEPT OF TAXATION

Taxation is the imposition of compulsory levies on individuals or entities by governments in almost every country of the world. Taxation is used primarily to raise revenue for government expenditures, though it can serve other purposes as well. The term "taxation" applies to all types of involuntary levies, from income to capital gains to estate taxes. Though taxation can be a noun or verb, it is usually referred to as an act; the resulting revenue is usually called "taxes." It is differentiated from other forms of payment, such as market exchanges, in that taxation does not require consent and is not directly tied to any services rendered. The government compels taxation through an implicit or explicit threat of force. Taxation is legally different than extortion or a protection racket because the imposing institution is a government, not private actors. There are few things one should know about taxation:

- Tax can be levied annually or on each transaction.
- Local, state and central authorities can levy taxes.
- All taxes must be deposited with the central or state tax authorities.
- Only state and central governments can reallocate the tax collection pool for investment and other purposes.

Benefits of Taxes

i. Paying taxes helps the government to run the nation smoothly. Listed below are a few benefits of paying taxes:

ii. Taxes help the state, and central government provide public services and develop amenities such as parks and schools. Also, a part goes to enhance the defence sector of the nation.

iii. It improves the living standards of citizens as taxation improves healthcare, education, and other sectors.

iv. It allows the government to offer various public schemes like unemployment benefits, pension schemes, etc.

v. Taxation documents help you get loans and credit cards as ITR serves as income proof.

vi. It also help citizens in their Visa application form as it is one of the proofs considered in the visa process.

There are two types of taxes: Direct Tax and Indirect Tax

Tax, of which incidence and impact fall on the same person, is known as Direct Tax, such as Income Tax. On the other hand, tax, of which incidence and impact fall on two different persons, is known as Indirect Tax, such as GST etc. It means, in the case of Direct Tax, tax is recovered directly from the assesses, who ultimately bears such taxes, whereas in the case of Indirect Tax, tax is recovered from the assesses, who passes such burden to another person & is ultimately borne by consumers of such goods or services.

Direct Tax	**Indirect Tax**
Incidence and impact fall on the sameperson	Incidence and impact fall on two different persons
Assesses, himself bears such taxes. Thus, it pinches the taxpayer.	Tax is recovered from the assesses, who passes such burden to another person. Thus, it doesnot pinch the taxpayer.
Levied on income	Levied on goods and services. Thus, this type of tax leads to inflation and have wider base.
E.g., Income Tax	E.g., GST, Customs Duty, etc.
Progressive in nature i.e., higher tax is levied on person earning higher income and vice versa.	Regressive in nature i.e., all persons will be are qual wrath of tax on goods or service consumed by them irrespective of their ability.
	Useful tool to promote social welfare by checking the consumption of harmful goods ors in goods through higher rate of tax.

16.4 MEANING OF TAXABLE INCOME

All income is considered as taxable, with some tax deductions and exemptions not included under the taxable income. This is applicable for all individuals, companies, Hindu Undivided Families (HUF), local authorities, body of individuals, etc. Taxable income is the amount of income subject to tax after deductions and exemptions. For both individuals and corporations, taxable income differs from and is less than gross income. It is the base income upon which tax is levied. It includes some or all items of income and is reduced by expenses and other deductions. The amounts included as income, expenses, and other deductions vary according to the country and the system in the country. Usually, all income is considered as taxable income, but some income have tax exemptions and deductions and hence won't be included under taxable income. Taxable income means the income which is chargeable to income tax, and it is calculated to decide how much tax an individual or a company owes to the government in a particular tax year. It is generally described as the gross total income or total income. To arrive at the total income, you have to consider any deductions or exemptions allowed in that tax year.

Taxable Income in India

The taxable income in India is levied on all individuals including Hindu Undivided Families (HUFs), companies, firms, body of individuals, local authority and any other artificial judicial person. The tax levied on every individual is different depending on their income. The tax levied is governed by Indian Income Tax Act, 1961.The income tax received by taxpayers is the main source of funding for the public services in the country.

How to Calculate Taxable Income?

Calculating taxable income is very easy and hassle free. To calculate the income tax to be paid, the customer has to add up all the income received and the tax liability is then reduced by deductions and exemptions. The official website of Income Tax India has a tax calculator on their website which is available to the public. The customer can use the tax calculator by providing a

few details to calculate their income. Listed below are few details that need to be filled out while calculating the tax:

- Assessment year
- Tax payer
- Residential status
- Income from salary
- Income from house property
- Capital gains
- Income from other sources
- Profits and gains
- Agricultural income
- Deductions

The formula for taxable income for an individual is a very simple prima facie, and the calculation is done by subtracting all the expenses that are tax exempted and all the applicable deductions from the total gross income. For an individual, it is represented as,

Taxable Income Formula = Gross Total Income – Total Exemptions – Total Deductions

On the other hand, the calculation of a corporation’s taxable income is done by deducting the cost of goods sold, operating expenses and interest paid on debts from the company’s gross sales. Additionally, adjustment for a tax deduction or credit is made to arrive at the final income. For Corporate, it is represented as,

Taxable Income Formula = Gross Sales – Cost of Goods Sold – Operating Expense – Interest Expense – Tax Deduction/ Credit.

The taxable income formula for an individual can be derived by using the following four steps:

1. Firstly, determine the total gross income of the individual. Gross total income includes all sources of income like wage/ salary, rental income from property, capital gains from the asset sale, income from other business interests, etc.

2. Next, determine the total exemptions availed by the individual. Different types of tax-exemption may include charities, humanitarian aids, educational materials, etc. The list may vary depending on the reporting country.

3. Next, determine the total deductions applicable to the individual's income. Different types of tax deductions may include interest on a student loan, interest on a home loan, medical expenses, etc. This list may also vary depending on the reporting country.

4. Finally, the taxable income formula is calculated by total exemptions and deductions from the individual's total gross income, as shown below.

Taxable Earning = Gross total income – Total exemptions – Total deductions

16.5 OBJECTIVES OF TAXATION

1. **Economic Development:** Economic development is one of the most essential goals of taxes. The expansion of capital formation is a major determinant of any country's economic progress. Capital formation is regarded to be the linchpin of economic progress. However, capital shortages are common in less developed countries. To address capital scarcity, governments in these nations deploy resources in order to accelerate capital formation. The government uses tax income to increase both public and private investment through various expenditures. With proper tax planning, the savings-to-national-income ratio may be raised with further helps the economy in development. Some economists advocate for tax reforms that will encourage economic growth. This strategy might require a qualitative reorganization of the tax system. However, tax incentives have a limit, especially when it comes to stimulating the economic development of specific businesses or areas.

2. **Non-Revenue Goal:** Non-Tax Revenue is the government's recurring revenue from sources other than taxes. They are extremely significant since they assist the government and enhance public finance. The decrease in income and wealth inequality is another non-revenue goal of taxes. This can be accomplished by taxing the wealthy at a greater rate than the poor, or by implementing a progressive taxation system.

3. **Price Stability:** Taxes may be used to maintain price stability, which is a short- term goal of taxation. Taxes are seen to be a good way to keep inflation under control. Increased direct tax rates can be used to limit private spending which further reduces excessive demand. Naturally, with this, the commodities market is under less stress. When it comes to indirect taxes on products, they worsen inflationary trends. On the one hand, high commodity prices discourage consumption while also encouraging saving. When taxes are reduced during deflation, the opposite impact occurs.

4. **Balance of Payment difficulties are Reduced:** Growing current account deficits are sometimes a sign of impending balance of payments problems. Capital inflows, other net currency inflows, or a decrease in foreign currency reserves are all required to fund current account deficits. Customs tariffs and other taxes are also used to regulate imports of particular commodities in order to reduce the severity of balance of payments problems and encourage domestic manufacture of import alternatives.

5. **Full Employment:** Since the level of employment is determined by effective demand. A government seeking to achieve full employment must lower its tax rate. As a result, disposable income will increase and in return demand for products and services will also increase. Increased demand will drive investment, resulting in a rise in income and employment through the multiplier effect. The bigger the disincentives to labor, the higher the tax wedges. Reduced marginal tax rates on earnings and wages, for example, people may be more motivated to work harder if they pay less tax on their profits.

16.6 PRINCIPLES OF TAXATION

1. **Horizontal Equity:** The horizontal equity concept is important in taxation and it suggests that people in similar or identical positions will have the same tax burden. It is an economic theory that maintains that people with identical incomes and assets should pay the same tax rate. Horizontal equity should apply to people who are regarded as equal for example, the personal income tax. Horizontal equity calls for two families in the same income to pay the same tax. But what if one family has eight children and the other has none? Or, what if one family has unusually high medical expense, while the other has none (even if two families have the same number of members)?

2. **The Ability-to-Pay Principle:** According to the ability-to-pay concept, individuals with a better ability to pay taxes (as measured by income and wealth) should pay more. This concept suggests that individuals who have achieved success should be ready to give back a bit more to the society that helped them achieve it. According to this, the overall tax burden should be allocated among individuals based on their ability to bear it, taking into consideration all relevant personal characteristics. In this instance, personal levies are the most suitable taxes.

3. **The Principle of Benefit:** Taxes, according to the benefit principle, serve a similar purpose to prices in private transactions. Namely, they aid in determining what activities the government will undertake and who will pay for them. In fact, most public services are difficult to apply the benefit principle because individuals are often unwilling to pay for a publicly supplied service, such as a police department unless they can be excluded from the service's advantages. The benefit concept is most successfully applied in the funding of roads and highways through vehicle fuel taxes and user fees (tolls), those who use have to pay for that.

4. **Stability:** Tax rules should be modified infrequently. When the tax rules are modified, they should be part of comprehensive and systematic tax

reform. The reform includes enough provisions for a fair and orderly transition. Frequent changes in tax legislation can lead to lower compliance or behaviour that tries to adjust for possible future changes in the tax system.

5. **Clarity:** Tax rules and regulations must be understandable to the average taxpayer. They must be as straightforward as feasible. Tax rules should be plain and definite. This not only leads to a significant amount of inaccuracy but also undermines honesty and respect for the law. Unclear tax will discriminate against the poor and the uninformed, who are unable to take advantage of the myriad legal tax-saving alternatives accessible to the educated and wealthy. Attempts to establish fairness have occasionally generated complications, contradicting reform goals.

16.7 CONCEPT OF DIRECT INVESTMENTS

Direct investment is more commonly referred to as foreign direct investment (FDI). FDI refers to an investment in a foreign business enterprise designed to acquire a controlling interest in the enterprise. The direct investment provides capital funding in exchange for an equity interest without the purchase of regular shares of a company's stock. The purpose of FDI is to gain an equity interest sufficient to control a company. In some instances, it involves a company in one country opening its own business operations in another country. In other cases, direct investment involves acquiring control of existing assets of a business already operating in the foreign country. A direct investment can involve gaining a majority interest in a company or a minority interest, but the interest acquired gives the investing party effective control. It is primarily distinguished from portfolio investment, the purchase of common or preferred stock shares of a foreign company, and by the element of control that is sought. FDI is frequently not a simple monetary transfer of ownership or controlling interest but can include complementary factors, such as organizational and management systems or technology. FDI can be made by individuals but are more commonly made by companies wishing to establish a business presence in a foreign country. From the above information we can say that:

- Direct investment or foreign direct investment, is designed to acquire a controlling interest in an enterprise.
- Direct investment provides capital funding in exchange for an equity interest without the purchase of regular shares of a company's stock.
- Direct investment may involve a company in one country opening its own business operations in another country.
- Direct investment can also involve acquiring control of a business's assets already operating in the foreign country.
- There are three general types of direct investment: vertical, horizontal, or conglomerate investment.

16.8 TAXATION OF DIRECT INVESTMENTS

According to the International Monetary Fund, foreign direct investments are defined as foreign investments in local companies that exceed 10% of the company's assets. Usually these refer to investments made by multinationals in companies controlled abroad, like subsidiaries or branches. The investment decision of a multinational company is complex and is based on a series of factors, among the most important being the location, how internationalized the country is and the degree of implementation of management policies. All of these elements are directly influenced by the taxation level adopted by the company.

At the same time, the value of foreign investments is important to all countries as they generate income in the state budget. The increase of foreign direct investments is seen as a positive aspect, not only from an industry point of view as shown by Yin [1999], but also from a social and economic point of view. Countries use tax incentives and tax reductions to stimulate the inflow of foreign direct investments. China, for instance, has reduced taxes from 30% to 15%-24% for investments in specific parts of the country (Easson 1992). Specific measures, otherwise known as "preferential tax measures", are designed to improve the competitive position of countries on a specific segment in order to attract new foreign investment. These measures may take the form of

permanent or temporary tax exemptions, reduced fees for foreign tax payers, special investment grants, the allowance of accelerated depreciation of assets, and special arrangements for expatriation. Examples of preferential arrangements in the EU aimed at attracting funding groups include the Belgian Coordination Centre Regime, the Irish International Financial Services Centre and the Dutch Group Financing Regime

There are two types of actual taxes that will be taken into consideration by every company that wants to expand to a different country:

- The effective average tax rate, calculated as the ratio of future taxes imposed on gross profit and the estimated duration of the investment project; this manages to determine which location is a more convenient benefit.
- The effective marginal tax rate, calculated as the product of ante and post-tax income statement for a marginal investment project, with no economic rent (in this case the gains are equal to the cost of capital); this manages to influence the size of investment.

16.9 CONCEPT OF POOLED INVESTMENTS

Pooled Investment refers to a group of investors injecting funds into a common pool to buy shares or units of an investment product/company. Generally, a pooled investment vehicle is one large portfolio of investment assets funded by numerous investors. Investors of these Pooled Investment Vehicles obtain their returns in the form of dividends or interest distributions and price appreciation as the investment's per-share or per-unit price rises. It is a financial product that combines investor funds together. It is used to purchase a variety of investments under one umbrella, allowing for diversification that individual investors may not be able to access on their own, at a lower cost. This helps reduce risk by spreading it over different assets, sectors, and strategies, while returns are earned through dividends, interest payments, and capital gains. Pooled investment vehicles are often used as an alternative to direct investing. They are managed by a team of fund managers or financial advisors who are experts in their respective fields that decide what investments

to make and how to allocate the pooled funds among them. These fund managers are paid an expense ratio for their services.

Advantages of Pooled investments

- The professional management helps to make sure investors receive the best risk- return trade-off while aligning with their work with the fund's objectives.
- The management helps investors who may lack the time and knowledge for handling their own investments entirely.
- It offer a range of investment options for the highly aggressive, mildly aggressive and risk-averse investor.
- Mutual funds allow for the reinvestment of dividends and interest that can purchase additional fund shares. The investor saves money by not paying transaction fees to hold all of the securities contained in the fund's portfolio basket while growing his portfolio.
- The investors save on transaction costs and further diversify their portfolios. Because funds contain hundreds or thousands of securities, investors are less affected if one security underperforms.
- With the help of pooled funds, groups of investors can take advantage of opportunities typically available to only large investors.

Disadvantages of Pooled investments

- When money is pooled into a group fund, the individual investor has less control over the group's investment decisions than if he were making the decisions alone.
- When the market is volatile, taking the time and effort to reach an agreement can take away opportunities for quick profits or reducing potential losses.
- When investing in a professionally managed fund, an investor gives up control to the money manager running it. In addition, he incurs additional costs in the form of management fees.

- Some mutual funds also charge a load or sales charge. Funds will vary on when this fee is billed, but most common are frontend loads paid at the time of purchase and backend loads paid at the time of divesting.
- An investor will file and pay taxes on fund distributed capital gains. These profits are spread evenly among all investors, sometimes at the expense of new shareholders who did not get a chance to benefit over time from the sold holdings.
- If the fund sells holdings often, capital gains distributions could happen annually, increasing an investor's taxable income.

16.10 TYPES OF POOLED INVESTMENTS

Pooled funds come in various forms, including real estate investment trusts (REITs), hedge funds, mutual funds, exchange-traded funds (ETFs), private equity funds, country- based pooled funds, pooled funds Philippines, and hedge funds. Each of these funds has its own strategies, restrictions, and investment objectives, providing investors with a high level of portfolio diversification regardless of the amount invested. The following are some notable examples:

Mutual funds: Mutual funds pool funds from numerous investors to create a diversified portfolio of assets, including bonds, securities, stocks, and other investments.

Exchange-traded funds (ETFs): ETFs are traded on security exchanges and hold a collection of securities. They offer the flexibility of trading individual stocks while providing diversification across multiple assets.

Hedge funds: Hedge funds are private investment funds that employ a wide range of strategies to generate potentially high returns for investors. However, they are characterized by high risk and typically target investors seeking higher yields than mutual funds.

Private equity funds: Private equity funds invest in privately held companies aiming to acquire or obtain controlling stakes in these firms. These funds play an active role in managing and growing the companies they invest in.

Real estate funds: Real estate funds invest in commercial or residential properties intending to generate capital appreciation and rental income. These funds provide investors with exposure to the real estate market without the need for direct property ownership.

Infrastructure funds: Infrastructure funds invest in infrastructure assets such as renewable energy projects, toll roads, or airports. They seek steady cash flows and capital appreciation from long-term infrastructure investments.

Sovereign wealth funds: Governments establish sovereign wealth funds to invest surplus reserves into a diverse range of assets, including bonds, real estate, and stocks. The primary goal of these funds is to generate long-term returns for future generations.

16.11 TAXATION OF POOLED INVESTMENTS

A pooled development fund (PDF) is a company that is registered as a PDF and provides development capital to small and medium sized companies. The PDF regime was closed to new applications for registration as a PDF from 21 June 2007.

- If a company was registered as a PDF part way through an income year and is still a PDF at the end of the income year, it is taxed as a PDF for the period from the date of registration to the end of the income year as if that period were an income year. The taxable income in the pre-PDF period is taxed at the rate of 30%.
- If a company ceases to be a PDF part way through an income year, it is taxed as an ordinary company for the whole year; that is, taxable income is taxed at the rate of 30% (or 26% if it is a base rate entity).
- The SME income component of the PDF's taxable income is taxed at the rate of 15%. The SME component is the company's SME assessable income less any deductions allowable to the company for the year, whether they relate to SME assessable income or not. If the available deductions exceed the amount of SME assessable income, the excess may be applied against the unregulated investment component of the company's taxable income.

- SME assessable income is income derived from, or from the disposal of, an SME investment and includes amounts that would otherwise be capital gains. An SME investment is not an unregulated investment which is an investment by way of a loan to, deposit with or debenture of a bank, or a deposit with an authorised money market dealer.
- The unregulated investment component of the PDF's taxable income is worked out by deducting the company's SME income component from its taxable income for the year. The amount (if any) remaining is the company's unregulated investment component. The unregulated investment component is taxed at the rate of 25%.
- Un franked dividends paid by a PDF are tax exempt in the hands of shareholders. Franked dividends paid by a PDF are also tax exempt in the hands of shareholders, unless the shareholder elects to be taxed. Where shareholders elect to be taxed, they can use the imputation credits attached to the franked dividend to offset other tax obligations.
- Taxation of capital gains made on the sale of shares in PDF are tax exempt.
- The income derived by PDFs from investments in companies, whether dividend, capital gains or other income, is taxed at 15 per cent rather than the full corporate tax rate. PDFs credit their franking accounts for tax paid but may frank a distribution up to the general corporate rate of 30 per cent. This enables them to pass on a greater franking benefit to their shareholders than would otherwise be warranted by the tax they have paid, where they have a surplus in their franking account.

16.12 SUMMARY

Nowadays the interaction between nations brings direct implications for increasing competition. Due to globalization, companies are forced to be more competitive, innovative and dynamic and all this represented an aim for passing the market test. Companies have managed to evolve in terms of internationalization through the emergence and development of new information

and communication technologies and by entering into new markets such as Eastern Europe and Central Asia, but also through trade liberalization based on WTO provisions. Taxation is cardinal in financing development undertaking. Revenue raised through taxation is more sustainable than reliance on borrowing. However, in order to raise sufficient revenue, there is need to have an effective tax system which should be developed by taking into account the discussed principles. Lastly, there could be other principles of taxation that have been developed but we affirm our earlier sentiments these principles presented in this paper are very vital and should be highly considered when developing tax laws. A tax assessment and determination should be easy to understand by an average taxpayer. A tax system should be easy for tax payers to comply. This among other reasons includes the design of a tax system. Normally taxpayers find it easy to comply when a tax system is easy to deal with.

16.13 GLOSSARY

- Pooled investment: It refers to a group of investors injecting funds into a common pool to buy shares or units of an investment product/company.
- Taxation: It is the imposition of compulsory levies on individuals or entities by governments in almost every country of the world.
- Price stability: It occurs when there is an absence of large swings in the general level of prices in the economy.
- Mutual funds: It is a financial vehicle that pools assets from shareholders to invest in securities, stocks, bonds, and other securities.

16.14 SELF-ASSESSMENT QUESTIONS

Q1. Write down the benefits of taxation.

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Q2. Discuss various principles of taxation.

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Q3. What do you mean by pooled investment?

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16.15 SUGGESTED READINGS

- https://www.geeksforgeeks.org/objectives-and-principles-of-taxation
- https://www.bankbazaar.com/tax/taxable-income.
- Taxable Income Formula by Ashish Kumar Srivastav
- https://www.investopedia.com/terms/d/direct-investment.asp
- https://www.realvantage.co/insights/what-is-a-pooled-investment-vehicle
- https://www.wallstreetmojo.com/pooled-fund.
- Christian Aid. (2014). Africa Rising? Inequalities and the essential role of fair taxation.

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UNIT-IV LESSON NO. 17

TAX ESTATE AND ADVANCE FINANCIAL PLANNING

INCOME TAX

STRUCTURE

17.1 Introduction

17.2 Objectives

17.3 Concept of Income Tax

17.4 Self-Assessment Tax and Payment of Income Tax

17.5 Capital Gains Tax

17.6 Types of Capital Gains Taxation

17.7 Tax Avoidance

17.8 Methods of Tax Avoidance

17.9 Tax Evasion

17.10 Difference Between Tax Evasion and Tax Avoidance

17.11 Summary

17.12 Glossary

17.13 Self-Assessment Questions

17.14 Suggested Readings

17.1 INTRODUCTION

Under the Constitution of India, Central Government is empowered to levy tax on the income of its citizens. Accordingly, the Central Government has enacted the Income Tax Act, 1961. The Act provides for the scope and machinery for levy of Income Tax in India. The Act is supported by Income Tax Rules, 1961 and several other subordinate and regulations. Besides, circulars and notifications are issued by the Central Board of Direct Taxes (CBDT) and sometimes by the Ministry of Finance, Government of India dealing with various aspects of the levy of Income tax. Unless otherwise stated, references to the sections will be the reference to the sections of the Income Tax Act, 1961. Income tax is a tax on the total income of a person called the assesee of the previous year relevant to the assessment year at the rates prescribed in the relevant Finance Act.

17.2 OBJECTIVES

After going through this lesson, you will be able to understand:

- Concept of Income tax
- Tax evasion and tax avoidance
- Meaning of capital gain tax
- Online procedure of tax pay

17.3 CONCEPT OF INCOME TAX

Income tax is a tax charged on the annual income of an individual or business earned in a financial year. The Income Tax system in India is governed by The Income Tax Act, 1961, which lays out the rules and regulations for income tax calculation, assessment, and collection. All taxpayers are mandated to submit an Income Tax Return (ITR) every year by respective due dates as per the law to report their income and claim a tax refund if applicable. An income tax return can be filed online or offline on the Income Tax Department's official website or through verified third-party websites. It is a form of taxation that individuals, Body of Individuals (BOI), Association of Persons (AOP),

Hindu Undivided Family (HUF), and businesses need to pay to the central government. The government levies the tax on your income during a financial year and uses the money for the country's development. The tax amount depends on your income and the tax slabs.

The term "income tax" refers to a type of tax governments impose on income businesses and individuals within their jurisdiction generate. By law, taxpayers must file an income tax return annually to determine their tax obligations.

Income taxes are a source of revenue for governments. They are used to fund public services, pay government obligations, and provide goods for citizens. In addition to the federal government, many states and local jurisdictions also levy income taxes.

16.4 SELF-ASSESSMENT TAX AND PAYMENT OF INCOME TAX

When filing your taxes, the TDS and advance taxes you paid during the year will be deducted from your final tax payable. If the amount you paid is not enough, you will need to pay the remaining balance to cover the difference, which is referred to as self-assessment tax. It is paid after the end of the financial year but before filing the income tax return. Paying this on time helps you avoid any penalty or interest. Every individual have to pay the Self- Assessment Tax (SAT) for income from other sources. Individuals are expected to compute the final liability of income tax after deducting the TDS amount from the source of income as well as the advance tax payable for the financial year. Individuals who are required to file their income tax returns are liable to pay their SAT beforehand. A taxpayer can file SAT by submitting Challan 280, also used for e-filing income tax. There is no specific date for paying SAT as it is computed at the end of a financial year. Hence, there is no deadline associated with the payment of such tax. Nevertheless, taxpayers must make SAT payments before filing their respective income tax returns to avoid paying interest on the tax amount. When the year is almost over, if there is any tax pending before filing an individual's income tax return, a final amount that the individual is liable

for is calculated is known as the self- assessment tax. This is the final calculation before filing the tax return. This is also known as SAT. There is no specification for the date of payment. It can be paid online through a few simple steps and can also be calculated with a simple procedure.

Generally, SAT is payable by an individual related to income from other sources. For example, if an individual has missed out on an income when making the final payment in the form of instalment of their advance tax, etc. It could also be a possibility that TDS was not deducted or done at a lesser rate against the higher tax rate applicable on your income tax filing. It happens often for salaried individuals that a fixed deposit or from short term bonds he or she have been able to earn a sizable amount and hence have not mentioned it to your employer, driving the amount not to be considered for tax deduction. Therefore the self- assessment tax will be required. SAT or self-assessment tax is paid for a particular financial year end. There is no specification on the date of payment of this tax. The ideal time is to pay it as soon as possible, without waiting for the tax returns filing date, as a way to avoid payment of interest on the tax amount.

How to Pay Self-Assessment Tax Online?

The taxpayer can make payments with regards to self-assessment tax in tax challan 280 (ITNS 280) either through online mode via the e-filing portal or through offline mode by way of making physical payment at a particular bank branch. Here are the following steps to pay the self-assessment tax online. However, note that the online tax payment platform only supports Net Banking:

- An individual can log on to the income tax website, www.incometaxindia.gov.in.
- Once he or she has signed in, an option “e-Pay taxes” will be visible.
- The person on clicking on this link will be redirected to the National Securities Depository Ltd, website.
- The individual can then select “challan no./ITNS 280” followed by “(0021) Income tax (other than companies)”.

- The person then needs to fill in the details such as PAN card details, name, contact details such as address, residential and official contact numbers and mobile numbers.
- The individual needs to then choose the appropriate year for assessment that he or she will be making the payment for.
- The person then needs to select the “type of payment”, which in this case will be “(300) Self-Assessment Tax”.
- The individual can then choose the bank of their choice from the dropdown menu to make the payment.
- He or she needs to then enter the “tax payable amount”.
- The individual will be then directed to their bank’s own Net banking page to make the payment.
- Once the payment is made successfully a challan will be displayed. This will include CIN, all the payment details along with the bank’s name with which the payment has been made.
- It is advisable to keep a scan or hard copy of the same.
- Generally after the SAT is paid, it reflects on the individual’s Form 26AS within a few days. If it does not show, the challan details can be filled in when filing the income tax return.

Procedure for Offline Payment of Self-Assessment Tax

The steps for offline payment of self-assessment tax are as follows:

Step 1: The assessee would be required to download and take a print-out of tax challan 280 from the Income Tax website.

Step 2: Fill in details like PAN, assessment year, residential address, email id, and mobile number.

Step 3: Lastly, the taxpayer shall submit the filled challan form physically to the bank along with the cheque/ cash/ demand draft and make payments towards the same. The receipt of the challan paid should be collected from the bank.

It is recommended that taxpayers should save a copy of the self-assessment tax paid challan as the same would be required to be furnished in the tax return in case the challan details take some time to reflect on the taxpayer's Form 26AS.

Why Should One Pay Self-Assessment Tax?

SAT has to be paid by individuals who earn income from other sources. The tax amount is levied for the following reasons:

- There might be some instances where a taxpayer fails to take an income into consideration while paying advance tax.
- Sometimes the TDS amount deducted might be inaccurate.
- A salaried employee may earn a substantial income from investments such as fixed deposits and mutual funds which may not be known to the employer.

Hence, self-assessment in income tax is essential to avoid inaccuracies in relation to the taxable income.

Calculation of Self-Assessment Tax

SAT can be calculated by using the following formula:

[(B+C) – (D+E+F+G)]

Where,

B= Total amount of tax payable

C = Interest payable under section 234A/234B/234C D= Relief on the tax payable under Section 90/90A/91 E= MAT Credit under Section 115JAA

F= Amount of TDS/TCS G= Advance Tax

Please note that interest under Section 234A will only be included in case of late filing of income tax returns; whereas, interest under Section 234B/234C will only be paid in case of late payment of Advance Tax.

17.5 CAPITAL GAINS TAX

Under the Income Tax Act, capital gains tax in India need not be paid in case the individual inherits the property and there is no sale. However, if the person who has inherited the property decides to sell it, tax will have to be paid on the income that has been generated from the sale. Capital gain can be defined as any profit that is received through the sale of a 'capital asset'. Such gains can be accrued either through the sale of investment or real estate property. The profit that is received falls under the income category. Therefore, a tax needs to be paid on the income that is received and that paid tax is called capital gains tax and it can either be long term or short term. The tax that is levied on long term and short term gains starts from 10% and 15%respectively.

In other words, we can say that capital gain refers to any gain or profit that is earned by the individual from the sale of a capital asset. The profit that arises from the sale of the capital asset is taxed under the head of 'Income from Capital Gain'. The profit is earned by selling the capital asset at a higher price than what it was bought for. This tax does not apply to the inherited property, as there is only a transfer of ownership and no sale. Any asset which is received as a gift by way of will or inheritance is exempted from the Online Income Tax Act 1961. However, CGT will be applicable if the individual who inherits the asset decides to sell it. An investor will owe long-term capital gains tax on the profits of any investment owned for at least one year. If the investor owns the investment for one year or less, short-term capital gains tax applies. The short-term rate is determined by the taxpayer's ordinary income bracket. For all but the highest-paid taxpayers, that is a higher tax rate than the capital gains rate. When stock shares or any other taxable investment assets are sold, the capital gains, or profits, are referred to as having been realized. The tax doesn't apply to unsold investments or unrealized capital gains. Stock shares will not incur taxes until they are sold, no matter how long the shares are held or how much they increase in value.

Key Points:

- Capital gains taxes are due only after an investment is sold.

- Capital gains taxes apply only to capital assets, which include stocks, bonds, digital assets like crypto currencies and NFTs, jewellery, coin collections, and real estate.
- Long-term gains are levied on profits of investments held for more than a year.
- Short-term gains are taxed at an individual's regular income tax rate, which is higher than the tax on long-term gains.

Here is an example of how it works:

Mr. B purchased a house for Rs. 50 Lakh in July 2004. The full value of consideration in the financial year of 2016-2017 stood at Rs. 1.8 Crore. The said property was held for over 36 months and was, therefore, deemed as a long-term capital asset.

After taking into consideration the inflation, the cost price was adjusted, and the indexed cost of acquisition was also taken into account.

The adjusted cost of the property was then settled at Rs. 1.17 Crore, which means Mr. B accrued a net capital gain worth Rs. 63 Lakh. After a long-term capital gains tax rate of 20% was levied on the net capital gain, the tax liability that was to be paid by Mr. B arrived at a total of Rs. 12,97,800.

17.6 TYPES OF CAPITAL GAINS TAXATION

There are two types of capital gains:

1. **Short-term Capital Gain Tax:** Any asset that is held for less than 36 months is termed as a short-term asset. In the case of immovable properties, the duration is 24 months. The profits generated through the sale of such an asset would be treated as short-term capital gain and would be taxed accordingly. In case the property has been inherited or given as a gift, the amount of time the property was held by the previous owner is also considered when determining whether the property can be considered as a short-term capital asset or a long term capital asset. The date on which the bonus shares were allotted is considered when determining the category under which bonus shares or right shares fall.

2. **Long-term Capital Gain Tax:** Any asset that is held for over 36 months is termed as a long-term asset. The profits generated through the sale of such an asset would be treated as long-term capital gain and would attract tax accordingly. Assets like preference shares, equities, UTI units, securities, equity-based Mutual Funds and zero-coupon bonds are also considered as long-term capital asset if they are held for over a year. The below-mentioned assets are considered as long-term assets if they are held for a duration of more than 12 months:

- Zero coupon bonds (not dependent on whether they are quoted or not)
- Unit Trust of India (UTI) units (not dependent on whether they are quoted or not)
- Equity-based mutual funds units (not dependent on whether they are quoted or not)
- Securities that are listed on a stock exchange that is recognized in India.
- Preference shares or equities that are held in a company that is listed on a stock exchange that is recognized in India.

17.7 TAX AVOIDANCE

Tax avoidance is the legal usage of the tax regime in a single territory to one's own advantage to reduce the amount of tax that is payable by means that are within the law. A tax shelter is one type of tax avoidance, and tax havens are jurisdictions that facilitate reduced taxes. Tax avoidance is the process of reducing the tax payable, given the deductions applicable to taxpayers. It helps reduce the tax burden of individuals and businesses, including major corporate. Tax avoidance should not be confused with tax evasion, which is illegal. It is anact to minimize tax liability through legal methods. It is not advisable as it could be used for one's advantage to reduce the amount of tax payable. It is also considered immoral because it involves dodging of tax, and it leads to the deferment of tax liability. One of the ways to do tax avoidance is to adjust the accounts in such a manner where there will be no violation of tax rules. Avoiding taxes is a legal way of decreasing the tax liabilities of a citizen or business unit in an economy.

- Tax avoidance reduces the tax amount through deductions and tax credits as applicable to individual taxpayers.
- Some avoidance methods include spending on investments, claiming deductions and tax credits, starting a business, etc.
- When one person avoids tax, it automatically increases the tax burden for the rest of the population.
- It is an ethical and legal way of minimizing the tax burden, unlike tax evasion, involving the false representation of data for evading taxes.

Tax avoidance helps individuals and entities adopt legal ways of avoiding their tax liabilities. This is achieved through deductions and credits that an economy allows to the taxpayers. In addition, individuals can prevent tax loads by making tax-advantaged investments, including 401(k)s and Individual Retirement Accounts (IRAs).Tax avoidance is lawful, but, in some cases, it could be considered as a fraud. Tax avoidance can be controlled through the implementation of stringent laws and regulations. The Government of India is trying to remove shortcomings and loopholes in existing laws by bringing amendments to ensure that people don't avoid tax payment by manipulating law. With the regular amendments implemented by the government through the tax budget, it is becoming difficult for the taxpayer to do tax avoidance.

17.8 METHODS OF TAX AVOIDANCE

There are various tax avoidance strategies to ensure taxpayers save on their income taxes and make their tax planning accordingly. Some of them have been listed below:

1. **Savings:** Spending on employer-sponsored savings schemes keeps individuals open to tax deductions. For example, IRAs help employees save a portion of their gross income to ensure a happy retirement life and let them enjoy significant tax benefits. For example, US citizens can contribute up to $ 19,000 to a 401(k) scheme if they are below 50 and up to $25,000 if they are 50 and above.

2. **Deductions:** The expenses that remain non-reimbursed could be filed and claimed under the annual tax return. However, this applies to only a specific set of workplace expenses, which are a must for employees to keep performing. Some such expenses include union dues, tools, personal conveyances, etc.

3. **Investments:** The governments allow deductions for investment in certain funds. For example, the mortgage payments are subject to offering tax benefits to the concerned investors. So, taxpayers must ensure making an investment that helps them enjoy some tax deductions. Home equity comes with tax-deductible interest. Individuals are allowed an amount to a limit, depending on their income, which could be used for annual deduction.

4. **Start-up:** One of the most efficient tax avoidance methods is to have a start-up, as business expenses tend to offer huge tax benefits to individuals. This is because the tax authorities allow all the business-related expenses for tax deductions. However, no personal expenses are included.

5. **Health Scheme:** Expenditures made for paying health, medical, and dental premiums offer tax-deductible advantages to the insurance holders and their dependents. The Health Savings Account (HSA) is a plan that allows individuals to enjoy major tax benefits. One can make payments for health and medical expenses using the insurance coverage and add it to the tax deduction list.

6. **Tax Credit:** The tax authorities let taxpayers claim for tax credits, which sometimes equate to a zero tax liability. This makes tax credit one of the best tax avoidance types for individuals and businesses. The Internal Revenue Service (IRS) has introduced multiple tax credits for taxpayers to claim. Some of these include the Earned Income Tax Credit, Advance Child Tax Credit, Energy Tax Incentives, Tax Relief in Disaster Situations, Federal Tax Deductions for Charitable Donations, etc.

17.9 TAX EVASION

Tax evasion happens when people or businesses use illegal methods to avoid paying the taxes they owe to the government. This is a serious crime, and those who do it can be charged with a crime and have to pay big fines. Tax evasion usually means lying about how much money you make, pretending your expenses are higher than they are, or doing secret transactions with cash. On the other hand, there are legal ways to pay less tax, like investing in different plans. This is called tax avoidance. Tax evasion and tax avoidance are words that are sometimes used to mean the same thing, but they're different. Tax avoidance is following the rules to pay less tax, while tax evasion is doing sneaky and against-the-law things to not pay tax. Tax evasion is an illegal act where you as an individual or company avoid paying the tax liability. For example, not paying taxes or paying less than what you should pay is considered tax fraud and comes under tax evasion. It may also include fabricating income, claiming deductions without proof, failing to declare cash transactions, etc.

- Tax evasion can be either the illegal non-payment or underpayment of actual tax liabilities due.
- Tax evasion can be determined by the IRS regardless of whether or not tax forms were filed with the agency.
- To determine tax evasion, the agency must be able to show that the avoidance of taxes was wilful on the part of the taxpayer.
- While tax evasion is illegal, tax avoidance includes finding legal ways (within the law) to reduce taxpayer obligations.

Methods of Tax Evasion

If you have wondered about tax evasion meaning and how it is done, people resort to various ways to evade tax payments. Some of the commonly used methods of tax evasion are:

1. **Misreporting in the Income Tax Returns:** Filing income tax returns is mandatory, according to the laws of India. To avoid paying the exact income tax amounts, some people and entities report incorrect

information in their income tax returns by providing false data relating to income, investments, and other deductions.

2. **Concealing Income:** Some people avoid showing a source of income by hiding cash transactions. For example, a landlord might accept rent in cash instead of a bank transfer or cheque. This is done when the landlord has not informed the authorities that the property has been rented and he is receiving some form of income against it.

3. **Storing Funds in Accounts Outside India:** Offshore accounts or accounts in international banks are maintained as information about these accounts is not disclosed to the Indian government. This is a common method of tax evasion.

4. **Falsification of Financial Statements:** The amount of taxes that a company or an individual has to pay is determined by the figures shown in the financial statements. One method of tax evasion is to falsify documents like balance sheets and profit and loss statements to show a lesser income than what was actually earned. This will reduce the amount of tax that is payable.

5. **Not Paying Taxes:** The simplest way to avoid paying taxes is to not pay the amount. Even when the dues are called for, the dues will not be paid to the government.

6. **Fake Documentation for Exemption:** There are some exemptions and privileges provided by the government to some underprivileged sections of society to provide them with more financial freedom. An unusual method of tax evasion, some citizens create false documents to show they are underprivileged to claim the benefits despite not actually belonging to those strata of society.

7. **Bribery:** One method of tax evasion is bribing the tax official to either change the tax liability or to make it disappear altogether.

Penalties for Tax Evasion

The income tax department can levy various kinds of penalties on people

and entities who resort to tax evasion. Some of the common penalties that are levied are:

- In case the income is undisclosed, Section 271(C) of the Income Tax Act states that a penalty of 100-300% can be levied. The exact percentage depends on the following:
- If the taxpayer acknowledges the undisclosed income and declares it, a penalty of 10% on the previous year's hidden income is levied.
- If the reason behind misreporting is an actual mistake, a penalty of 50% on the previous year's hidden income is levied.
- If there is a genuine intention to conduct tax evasion, a penalty of 300% on the hidden income is levied.

If the officials conduct any kind of a raid to discover the undeclared income, the penalty is levied according to Section 271(AAB)

- If the due taxes are not paid, the tax officials can impose a penalty amount. This penalty amount has to be lesser than the monetary amount of taxes.
- According to Section 139 Subsection 1 of the Income Tax Act of 1961, income taxes have to be filed within the tax filing period of each financial year. From 2020-21 onwards, the penalty for filing a late income tax return is Rs. 5,000.
- If accurate information is not provided while filing the income tax return, penalties are levied. The PAN card is used to deduct TDS or tax-deductible at the source from the salary.
- If the PAN card number is not provided, instead of deducting 10% as TDS, 20% will be deducted.
- If an incorrect PAN number is provided, a penalty of Rs. 10,000 is levied.

In some situations, it is possible that the person filing the income tax notices some inaccuracies after the report has been filed, and it might not be possible to correct these within ten days of submission. In this case, a penalty of Rs. 50,000 is levied.

- Businesses or employers who deduct TDS must have a tax deduction account number or TAN. If they don't have a TAN, a penalty of Rs. 10,000 is levied. Two kinds of tax evasion can be committed here:
  - In case the tax at source is not collected, the penalty is the same as the tax that was not deducted at the source.
  - If the TDS return is not filed within the specified time, a tax has to be paid for every day of delay until the entire amount is paid. This tax usually starts from Rs. 10,000 and goes up to Rs. 1,00,000.
- In case any inconsistencies are found in the ITR, the income tax department might issue demand notices. The demand notice contains details of the amount of tax still owed, and 30 days are given to the taxpayer to respond to the same. Failure to respond and pay the remaining tax can result in a penalty.
- Under Section 140A (1) of the Income Tax Act, failure to pay tax as per the self- assessment can result in a penalty. The assessing office can levy the penalty, which is the total value of tax owed to the government. Only if there is a valid reason for non- payment of the tax will the penalty be waived.
- Under Section 44AB, if an organisation does not get audited or does not submit an audit report, a penalty is levied. This penalty is either Rs. 1,50,000 or 0.5% of the sales turnover, whichever is more.
- Additionally, under Section 92E, the taxpayer must get a report from an accountant or pay a penalty of Rs. 1,00,000 or more.

17.10. DIFFERENCE BETWEEN TAX EVASION AND TAX AVOIDANCE

It's not a terrible thing to want to lower the tax rate. Every taxpayer who is supposed to pay taxes looks for different methods to avoid paying taxes and reduce their tax liability. They look for legal and unlawful ways to lessen their tax responsibilities, and as such, the two most common strategies adopted

by taxpayers are the practice of tax evasion and tax avoidance. The legal way of reducing tax obligations by taking advantage of legislative flaws is tax avoidance. Tax evasion is the practice of reducing tax liabilities using unethical or prohibited tactics, such as income reduction. The primary difference between tax evasion and tax avoidance is that tax evasion is considered a crime globally, whereas tax avoidance is not.

Tax avoidance is the use of legal approaches to avoid paying taxes. Meanwhile, tax evasion is using deceitful and fraudulent methods to evade tax payments. While the former is considered completely legal, the latter is a criminal offence. Today, tax evasion and tax avoidance in India have become the two most prevalent practices to reduce tax burdens. Hence these are some points that help us to understand the difference between tax avoidance and tax evasion:

BASIS FOR COMPARISON	TAX AVOIDANCE	TAX EVASION
Meaning	Minimization of tax liability, by taking such means which do not violate the tax rules, is Tax Avoidance.	Reducing tax liability by using illegal ways is known as Tax Evasion.
What is it?	Hedging of tax	Concealment of tax
Attributes	Immoral in nature means involves bending the law without breakingit.	Illegal and objectionable, both in script and moral.
Concept	Taking unfair advantage of the shortcomings in the tax laws.	Deliberate manipulations in accounts resulting in fraud.
Legal implication	Use of Justified means	Use of such means that are forbidden by law
Happened when	Before the occurrence of tax Liability.	After tax liability arises.
Type of act	Legal	Criminal
Consequences	Deferment of tax liability	Penalty or imprisonment
Objective	To reduce tax liability by applyingthe script of law.	To reduce tax liability by exercising unfair means.

17.11 SUMMARY

Every taxpayer should duly pay his self-assessment taxes, if any, after factoring the TDS/TCS, Advance tax and any other tax credits (rebates, foreign tax credit, etc) in order to avoid unnecessary interest and penalty burden. Further, every taxpayer should verify the self- assessment tax payment details in the challan with those details as mentioned in Form 26AS/AIS/ TIS. However, it is recommended to maintain a reasonable time gap between the payment of self-assessment tax and furnishing of tax return as the details of such self- assessment tax payment may take some time to reflect in the Form 26AS/ AIS/ TIS. In the absence of such details, the taxpayer may manually furnish the challan details in the tax return. Also, the taxpayer needs to ensure that the details in the challan are properly filled in for the payment of self-assessment tax, especially the assessment year in concern. In case of any incorrect details, the taxpayer needs to apply for correction to the relevant assessing officer. However, in case of offline payment, the taxpayer may have an option of correcting the details by way of filing a challan correction application form with the relevant bank within 7 days of such payment.

17.12 GLOSSARY

- Deductions: A deduction is an expense that can be subtracted from a taxpayer's gross income in order to reduce the amount of income that is subject to taxation.
- Capital gain: It is the profit one earns on the sale of an asset like stocks, bonds or real estate. It results in capital gain when the selling price of an asset exceeds its purchase price. It is the difference between the selling price (higher) and cost price (lower) of the asset.
- Self-assessment tax: The self-assessment tax mechanism is most commonly how self- employed tax payers to ensure they pay their due tax prior to completion of the financial year and before filing their tax returns.

17.13 SELF-ASSESSMENT QUESTIONS

Q1. Differentiate Tax Avoidance and Tax Evasion.

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Q2. Elaborate the term capital gain tax.

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Q3. Why one should pay income tax? Explain.

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17.14 SUGGESTED READINGS

- https://groww.in/p/tax/self-assessment-tax
- https://www.bankbazaar.com/tax/self-assessment-tax.html
- Tax Avoidance by Dheeraj Vaidya
- What is Tax Evasion ? Learn About Its Common Methods and Penaltiespaytm.com/blog/tax/what-is-taxevasion

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UNIT-IV **LESSON NO. 18**

TAX ESTATE AND ADVANCE FINANCIAL PLANNING

ESTATE PLANNING

STRUCTURE

18.1 Introduction

18.2 Objectives

18.3 Meaning of Estate Planning

18.4 Importance of Estate Planning

18.5 Parties involved in Estate Planning

18.6 Common mistakes to Avoid at the time of Estate Planning

18.7 Concept of Will

18.8 Other modes of Estate transfer

18.9 Administration of an estate

18.10 Types of Estate Administration

18.11 Process of Estate Administration

18.12 Other methods of passing Assets

18.13 Power of attorney

18.14 Types of Powers of Attorney

18.15 Tax planning through wills

18.16 Tax planning through trusts

18.17 Summary

18.18 Glossary

18.19 Self-Assessment Questions

18.20 Suggested Readings

18.1 INTRODUCTION

It seems like many people devote more time to planning a vacation, choosing a car to buy, or even selecting a spot to eat dinner than they do to estate planning deciding who will inherit their assets after they're gone. It may not be as fun to think about as booking a trip or checking out restaurant reviews, but without estate planning, you can't choose who gets everything that you worked so hard for. Estate planning is one of the important activities of financial planning. The process of financial planning is not complete without this step but still In India Estate planning is not taken seriously. Many think that only those who are affluent should do estate planning. But this is not true. Everyone who is earning and creating wealth and assets should have a succession plan through estate planning. One more myth about this is that only once you are in your later years of life you should think of estate planning. This is not correct. One has to have a proper plan for distributing his/her wealth , assets or even liabilities from the younger age itself. Despite the benefits of estate planning, the current scenario in India suggests that many individuals do not engage in estate planning, either due to a lack of awareness or because of cultural factors. In India, the concept of estate planning is relatively new, and there is a general perception that discussing death and inheritance is a taboo subject. This often leads to families not discussing their assets and inheritance plans, which can cause problems in the future. Additionally, many individuals may not engage in estate planning due to a lack of understanding of the legal and financial aspects involved. They may also underestimate the importance of estate planning or assume that it is only relevant for the wealthy. However, regardless of an individual's wealth or social status, estate planning is essential to ensure that

their assets are protected, and their heirs or beneficiaries are taken care of. In recent years, there has been a growing awareness of the importance of estate planning in India, and many financial advisors and legal professionals now offer estate planning services to individuals. Estate Planning has been around for many years, but it's becoming increasingly more and more common.

18.2 OBJECTIVES

After going through this lesson, you will be able to understand:

- Concept of Estate Planning
- Meaning of Power of attorney
- Concept of will and trusts
- Modes of Estate transfer

18.3 MEANING OF ESTATE PLANNING

The term estate planning refers to the preparation of tasks that serve to manage an individual's financial situation in the event of their incapacitation or death. The planning includes the bequest of assets to heirs and the settlement of estate taxes and debts, along with other considerations like the guardianship of minors and pets. Most estate plans are set up with the help of an attorney experienced in estate law. Some of the steps included in estate planning typically include listing assets and debts, reviewing accounts, and the writing of wills. It also involves determining how an individual's assets will be preserved, managed and distributed after death or in the event they become incapacitated. It also involves consideration of factors such as potential long-term care expenses, charitable giving, and guardianship arrangements for minor children. It also involves tax planning, which can help to minimise the amount of taxes that will be due on a person's estate after their death. Estate planning is not just for the wealthy, it's important for everyone, regardless of their net worth, to have an estate plan in place to ensure that their assets are distributed according to their wishes and to minimise the burden on their loved ones in the event of their passing. It's also important to review and update your estate plan

periodically as your life and circumstances change. The goal of estate planning is to ensure that a person's assets are distributed according to their wishes, while minimising taxes and other expenses. Estate Planning is simply the process of making it clearly known how you want your estate to be handled after you pass or if you're incapacitated and unable to handle things on your own. The most common **Estate Planning definition is,** "the process of making plans for the management and transfer of your estate after your death, using a Will, Trust, insurance policies and other devices." There are many parts of Estate Planning, but the first thing you must do is conduct a comprehensive review of your estate assets. Your estate is made up of all the property you own, including:

- Cash
- Cars
- Clothes
- Jewellery
- Houses
- Investments
- Savings
- Retirement accounts
- Land

18.4 IMPORTANCE OF ESTATE PLANNING

Estate planning is important because it allows you to have control over the distribution of your assets after your death, minimise taxes and other expenses, protect your assets, ensure that your loved ones are provided for and make arrangements for long term care and incapacity.

1. **It ensures that your assets are distributed according to your wishes:** Estate planning allows you to specify how you want your assets to be distributed after your death. This can provide peace of mind, knowing that your assets will be distributed according to your wishes, rather than being decided by a court.

2. **It helps to minimise taxes and other expenses:** Estate planning can also help to minimise taxes and other expenses associated with the distribution of your assets. For example, creating a trust can help to reduce the amount of estate taxes that will be due on your assets.

3. **It helps to protect your assets:** Estate planning can also help to protect your assets from creditors, lawsuits, and other potential claimants. For example, creating a trust can help to protect assets from creditors, while creating a limited liability company can help to protect assets from lawsuits.

4. **It helps to ensure that your loved ones are provided for:** Estate planning can also help to ensure that your loved ones are provided for in the event of your death. For example, creating a will can help to ensure that your minor children are cared for by the guardians of your choosing and creating a power of attorney can help to ensure that someone is able to manage your affairs if you become incapacitated.

5. **It can also include arrangements for long-term care and incapacity:** Estate planning can also include arrangements for long-term care and incapacity, such as a living will or advance healthcare directive, which can help to ensure that your end of life care is carried out according to your wishes.

18.5 PARTIES INVOLVED IN ESTATE PLANNING

Estate planning helps an individual to decide how his/her assets will be managed and owned after their death or incapacitation. It is a tax-proficient, easy way of transferring the assets to the family and there are various parties involved in estate planning.

1. **Settlor/Grantor:** A settlor is an individual who creates the estate and is the owner of the assets in the estate planning. They create a trust to hold the assets on behalf of the beneficiary or legal heirs. The beneficiary can be an individual or a group of individuals.

2. **Trustee:** A trustee is appointed by the grantor to look after the assets in

the trust. They are paid for their time and service out of the trust funds. The trusts are run like a business, where the trustee can make any revenue-generating decisions in growing the trust.

3. **Beneficiaries/Heirs:** Beneficiaries are the ones for whom the assets are planned for. It is stated in the agreement, which is managed by the trustee. If they find the trustee to be unfit to manage the assets, they have the legal right to replace them.

18.6 COMMON MISTAKES TO AVOID AT THE TIME OF ESTATE PLANNING

Take caution when developing your Estate Plan. There are many mistakes that could result in delays, inaccuracies or other misunderstandings. Some of the common mistakes people make along the way include:

- Not having an official plan
- Not updating a plan over time (at major lifetime events)
- Not making arrangements for if they become incapacitated
- Improper ownership of assets (how easy will it be to pass assets on)
- Not including charitable gifts
- Not appointing a guardian for children or others who would need their care
- Underestimating the implication of taxes
- Not having liquidity of assets
- Not making gifts during their lifetime to reduce the value of the estate after passing.
- Putting their child's name on the deed to property (potentially huge tax implications)

18.7 CONCEPT OF WILL

One of the most common and effective ways to carry out estate planning

is through a will. A will is a legal document that outlines how a person's assets will be distributed after their death. It allows individuals to have control over who inherits their assets and can also provide instructions for the care of dependents. Generally speaking, a will is a legal document that coordinates the distribution of your assets after death and can appoint guardians for minor children. This document is used to name a beneficiary and state who should receive your property upon your death. The document also allows you to appoint a legal representative to carry out these wishes. A will only goes into effect after death and passes through probate. Probate is a legal process that takes place in court after someone dies. The process takes time and often results in less money going to the beneficiaries due to attorney and court fees. In probate, the information is public which can result in people fighting over the assets and money. Two important things that can be done with a will but not with a trust, are to name a power of attorney and a guardian for children. A will is important to have, as it allows you to communicate your wishes clearly and precisely. It is advisable to work closely with an attorney to create and update your will. Without a will, the state in which you reside decides how to distribute your assets to your beneficiaries according to its laws. This is known as dying intestate, and the resulting settlement process may not produce the results that you would prefer for your survivors. You can prevent this from happening by having documents drafted that reflect your wishes. When someone creates a Will, they are called the testator. The executor, appointed by the testator, is responsible for carrying out the instructions in the Will. To do this, the executor must initiate a probate process by applying to a competent court for permission to distribute the property according to the testator's wishes. Their primary duty is to ensure the Will is executed as written by the testator.

To create a will in India, the individual must be of sound mind, over the age of 18, and must sign the document in the presence of at least two witnesses. The will must also be attested by the witnesses, who should not be beneficiaries of the will. It is recommended to seek the assistance of a lawyer or professionals while drafting a will to ensure it is legally valid and covers all necessary aspects. When drafting a will, it is important to list all assets, including property,

investments, bank accounts, and personal belongings, and specify how they should be distributed among beneficiaries. The will should also name an executor, who will be responsible for carrying out the provisions of the will and handling any legal proceedings related to the estate. It is essential to keep the will up-to- date and review it periodically to ensure that it reflects any changes in the individual's personal circumstances, such as marriage, divorce, or the birth of a child. A properly executed and updated will can provide peace of mind to the individual and their loved ones, ensuring that their assets are distributed according to their wishes.

18.8 OTHER MODES OF ESTATE TRANSFER

When thinking about estate planning, many families focus on creating a will or trust. But it's critical not to neglect other ways assets can be transferred either directly to beneficiaries who are named on accounts and policies, or by operation of law when assets are owned through joint tenancy with rights of survivorship (JTWROS), typically for real estate or other assets. Unlike a will or trust, passing on assets via beneficiary designation and JTWROS is generally easy, low-cost, and like a trust, avoids probate that is, the often-expensive and time-consuming process of transferring assets through a court process whether through a will or a state's inheritance laws. However, because beneficiary designations and accounts held as JTWROS supersede both wills and trusts, a lack of coordination between those methods and the rest of your estate plan could jeopardize your entire estate plan and have significant unintended estate tax consequences./

For example, let's say that Sally's revocable trust provides that all assets pass equally to her 3 children. However, her IRA beneficiary designation has not been updated since her first child was born and names only 1 of her 3 children as a beneficiary. Upon her death, that child would inherit 100% of Sally's IRA.

Or consider Mitch, whose will leaves assets in trust for his 20-year-old son, whom Mitch believes needs help managing the assets until he is 35. However, his son is also named as the transfer on death (TOD) beneficiary for

his investment accounts. As a result, if no changes are made to the TOD designation, his son will receive those assets outright, rather than in trust.

In those situations, even though Sally and Mitch likely spent a considerable amount of time and money putting wills and trusts in place that reflected their goals and objectives, their intentions were thwarted because their account titling and beneficiary designations were not aligned with their wills and trusts./ To help remedy this disconnect, Assets can be distributed at death in several ways, such as with a beneficiary designation, through a jointly held account, by probate, or a trust.

1. **Passed to a beneficiary:** This most frequently applies to life insurance policies, annuity contracts, retirement accounts such as IRAs, 401(k) plan accounts, and Roth IRAs, and savings and investment accounts. It considered:

- When naming individual beneficiaries, you lose the protection that passing assets in trust for that beneficiary may provide.
- For accounts that increase and decrease in value, you may not be able to easily assess how much is being left to each heir.
- Beneficiary designations must be updated each time a new account is opened./ It's not uncommon to see an old account with a named beneficiary and a more recent one without./ /
- If the primary beneficiary and contingent beneficiary die before the account owner, the account will pass through the probate process and according to the heirs identified in the owner's estate plan or the laws of intestacy.
- It may cause difficulties for the executor of the estate if there aren't enough assets passing through probate to satisfy the expenses, debts, and taxes of the estate.

2. **Passed by law:** These are typically assets passed by JTWROS (or in the case of married couples, also tenancy by the entirety), often real estate or joint bank or investment accounts. In these cases, at the death

of one owner, the property automatically transfers to surviving owner(s) outside of probate (and outside of any provisions in a client's will or revocable trust). In states with community property laws, spouses are usually co-owners of any assets acquired after the formation of the marriage. Community property may be transferred automatically, provided the asset is properly titled, and/or by a community property agreement and the consideration comes under it are

- There are 2 other types of joint ownership, known as tenants in common and community property (without right of survivorship)./ In those cases, when a joint owner dies, that owner's property interest becomes part of the deceased owner's estate and subject to probate.
- If the other party in a JTWROS agreement is a non-spouse, the asset may be subject to gift taxes.
- Since the asset may be accessible to the co-owner's creditors, there may be asset protection and liability concerns.

3. **Passed via trust:** In this arrangement, the trustees of the trust hold the trust assets on behalf of beneficiaries, and they are passed based on what the trust agreement specifies./ The considerations are:

- A trust only governs assets owned by the trust; that is, trust assets include only those assets titled in the name of the trust./
- In some cases, a will may be relied upon to transfer assets to a trust at death./ This type of will is referred to as a "pour-over" will./ However, any assets that pass through a will are subject to probate.

4. **Passed by probate:** Generally speaking, if an asset does not pass by law, contract, or trust, then the assets will usually pass to heirs via a will through a legal process known as probate./ Depending on the value of the estate and which state the deceased resides in, probate could take as long as several years, and fees can be significant which is considered by:

- Probate is a public record, so it decreases the level of privacy for the

family but it can be a time consuming process and typically includes court appearances and a lot of paperwork.

- If the deceased owned real estate in more than one state, the deceased's assets may be subject to probate in more than one state./ This is referred to as "ancillary probate" and can further complicate the settlement of an estate since each state has its own set of rules and procedures for the process.

18.9 ADMINISTRATION OF AN ESTATE

Administration of Estate refers to the actions necessary to guide an Estate through the probate process. This involves paying off any debts, closing accounts, and distributing property to heirs after someone has died. The exact responsibilities will be specified within the deceased individual's Estate Plan or by state law. It is a legal process that takes place after a person's death to manage and distribute their assets to their beneficiaries. This process involves identifying the deceased person's assets and liabilities, paying off debts and taxes, and distributing the remaining assets to the beneficiaries according to the instructions in the will or, if there is no will, according to state laws. Estate administration can be complex and time-consuming, which is why many people choose to hire an estate planning lawyer to assist with the process. In most cases, the Administrator of Estate will be compensated for their duties — as managing an Estate through probate can be a time-consuming process. Often, the deceased will opt to leave money or other assets to the Administrator within their Will. If there is no Will, the state will decide how to compensate the Administrator.

Duties of Administrator of an Estate

The exact role of the Administrator of an Estate will vary depending on the size of the Estate, and whether or not there was an Estate Plan. That being said, here is an outline of typical Administrator of Estate responsibilities:

- Gather the belongings, assets, financial accounts of the deceased
- Take note of any outstanding debts or bills

- File an inventory of all assets and debts with the Court
- Issue a Notice to Debtors and Creditors
- Request life insurance policies payable to the Estate
- Settle any debts and collect any money owed to the deceased
- File state and federal tax returns for the Estate, as well as any gift tax returns that are needed
- Communicate with the heirs and beneficiaries about the Estate
- Distribute assets and property according to the Estate Plan or state law

18.10 TYPES OF ESTATE ADMINISTRATION

Estate administration is the process of managing a deceased person's assets and liabilities, with the aim of distributing those assets to the rightful beneficiaries which is done mainly by two types that are given below:

A. **Testate Administration:** Testate administration occurs when the deceased has left a valid will. In this case, the person named as the executor in the will is responsible for carrying out the instructions contained in the document. The executor has the authority to manage the deceased person's assets, pay off debts and taxes, and distribute the remaining assets to the beneficiaries according to the will.

B. **Intestate Administration:** Intestate administration occurs when the deceased did not leave a valid will. In this case, the court appoints an administrator to manage the estate. The administrator's role is similar to that of an executor, but they must distribute the assets according to the laws of the state where the deceased resides. The distribution will typically be made to the deceased person's spouse, children, or other close relatives.

18.11 PROCESS OF ESTATE ADMINISTRATION

The estate administration process can be lengthy and complex, but it is

necessary to ensure that the deceased's assets are distributed correctly. The following are the steps involved in the process.

1. **Identification of Assets and Liabilities:** The first step in estate administration is to identify all of the deceased person's assets and liabilities. This includes any property, bank accounts, investments, personal belongings, and debts. The executor or administrator must take an inventory of all these assets and liabilities and ensure that they are accurately valued.

2. **Valuation of Assets:** Once all the assets and liabilities have been identified, the executor or administrator must have them valued. This is necessary to determine the estate's total value and ensure that the assets are distributed fairly among the beneficiaries. Valuation can be done by a professional appraiser or by using asset market values.

3. **Payment of Debts and Taxes:** The executor or administrator must ensure that all debts and taxes the deceased person owes are paid off before the assets can be distributed to the beneficiaries. This includes any outstanding loans, mortgages, credit card debts, and taxes. The executor or administrator must also file the deceased person's final tax return.

4. **Distribution of Assets to Beneficiaries:** Once all the debts and taxes have been paid, the executor or administrator can distribute the remaining assets to the beneficiaries. This should be done according to the instructions contained in the will or, if there is no will, according to the laws of the state. The distribution should be done fairly and with the best interests of the beneficiaries in mind.

5. **Final Accounting and Closing of the Estate:** After all of the assets have been distributed, the executor or administrator must prepare a final accounting of the estate. This includes a detailed report of all the assets, liabilities, and expenses involved in the administration process. Once the final accounting has been approved by the court, the estate can be closed.

18.12 OTHER METHODS OF PASSING ASSETS

Estate and inheritance planning offers the opportunity to create a lasting legacy while also ensuring the financial security of your heirs. However, passing on an inheritance can be complex and requires careful consideration to ensure that the wishes of the deceased are met, while also ensuring the interests of beneficiaries are protected. Although a will is the standard method of transferring assets, there are several other ways to do so, such as trusts, joint ownership, gifting, and more.

1. **Create a Will:** A will is a legal document documenting how a person's assets will be distributed after their demise. The will specifies the beneficiary, the portion or amount they shall receive, and any other conditions that need to be met. It can also name an executor who will manage any estate and carry out the instructions outlined in the will. That said, laws pertaining to wills may vary from state to state and drafting a will may not guarantee that your assets are distributed according to your wishes.

2. **Set up a Trust:** Trusts are a highly popular option for passing on inheritance because they offer greater control over the distribution of assets to beneficiaries. By establishing a trust, you can specify how and when your assets will be distributed to your beneficiaries. This is especially beneficial if you have concerns about your beneficiaries' financial management skills or if you want to protect your assets from creditors. It may be wise to appoint a trustworthy financial advisor or company to manage the trust for you and oversee distributions. Trusts are most commonly used to pass on an estate to children, in which case a revocable trust is ideal. If you have a large amount of wealth that you want to pass on to your children, consult your financial planner about setting up a trust that can automatically be passed on to your heirs after your demise.

3. **Add a Joint Owner:** If you have a property that you want to pass on to a specific individual, adding them as joint owners of the property is one

way to accomplish this. By doing so, they automatically inherit the property upon your demise since they are part owners. However, it's essential to consider the legal and tax implications of joint ownership. If you don't want the beneficiary to have any control over the property while you're alive, joint ownership may not be the best option since it grants them a certain amount of control over the property. Additionally, owning a property involves indirect costs like taxes and maintenance expenses. It is advised to consult an attorney or a financial advisor before making this decision.

4. **Invest in a Retirement Account:** Passing on assets as inheritance can be made easy by investing in a tax-free retirement plan. Employer-sponsored tax-deferred retirement accounts, such as IRAs and 401(k)s, are among the most popular options. If you're already contributing to one of these accounts, consider speaking with a financial advisor about maximizing your investment. Although these accounts are intended for retirement, they allow you to designate a beneficiary, making them an effective way to pass on an inheritance. Upon your passing, the assets saved under your retirement account can be transferred to your beneficiary without undergoing the probate process. Your beneficiary will have several options for managing the inherited funds, including rolling the IRA or 401(k) into their account, transferring the funds directly to their bank account, or leaving the account as-is to continue growing. However, note that leaving the assets untouched for more than ten years will require withdrawing the full amount.

5. **Consider giving Gifts:** Giving inheritance in the form of gifts can be a good idea if you have financial leverage. Gifting assets to your beneficiaries during your lifetime can help reduce the size of your estate and lower the tax burden for your heirs. Currently, the annual gift tax exclusion is $17,000, which means you can give a gift equal to that amount without incurring a gift tax. However, it is advised to consult with a professional who can help you understand the gift tax regulations before you give a large amount of money as a gift, as the beneficiaries

may face capital gains taxes. If you're gifting to children or grand children, establishing a Uniform Transfers to Minors Act (UTMA) or Uniform Gifts to Minors Act (UGMA) account can be beneficial. These accounts are custodial savings accounts for minors, and the assets are transferred to the beneficiaries once they reach legal age. UTMA accounts can hold any asset, while UGMA accounts only contain financial assets. Setting up these accounts can be tax-efficient since the beneficiaries will be taxed at a lower rate on their gifts.

6. **Buy a life Insurance Policy:** Life insurance policies can be another way to pass on an inheritance. There are two primary types of life insurance: term and permanent. Term life insurance provides coverage for a specified period, while permanent life insurance provides coverage for the duration of your life. The major con associated with term insurance is that if you outlive the designed period, no pay-out shall be made to your beneficiary. When you purchase a life insurance policy, you designate a beneficiary or beneficiaries who will receive the death benefit. The death benefit is typically tax-free. However, the life insurance pay-out in some states may attract taxes. Do consult with your advisor before making any decision.

7. **Make charitable donations and set up a special needs trust:** Charitable donations are one of the most popular ways to pass on an inheritance and lower the tax burden on your estate. Charitable donations can be made through your will or trust, or you can set up a charitable foundation in your name. In addition, if you want to pass your inheritance to a loved one with special needs, you can set up a special needs trust. This type of trust allows for the transfer of assets without affecting the individual's eligibility for government benefits such as Medicaid or Supplemental Security Income. To establish a special needs trust, it's crucial to consult with an experienced attorney who can help set up the trust, select a trustee, and create a detailed plan for using the trust funds. The trustee will manage and use the funds to provide for the individual's needs, such as medical care, housing, and transportation. Setting up a

special needs trust ensures that your loved one with special needs is taken care of for years to come.

8. **Establish an Education Fund:** Creating an education fund can be a good way to pass your inheritance and invest in your loved ones' future education. There are various ways to establish an education fund, such as setting up a trust with your intended beneficiaries or opening a 529 college savings plan, which allows for tax-free growth of funds as long as the money is used for qualified education expenses. You can also consider creating a Coverdell Education Savings Account or a custodial account under the Uniform Gifts to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA). Ensure that you set clear guidelines and instructions for how the funds should be used and accessed. This can include requirements for maintaining a specific grade point average or pursuing a particular field of study. Doing so will help you set your beneficiaries up for success and leave a lasting legacy for your family.

18.13 POWER OF ATTORNEY

Power of Attorney, or POA, is a legal document giving an attorney-in-charge or legal agent the authority to act on behalf of the principal. The attorney in charge possesses broad or limited authority to act on behalf of the principal. The agent can make decisions regarding medical care, financial matters, or property on behalf of the principal.

A power of attorney comes into play in the event that the principal is incapacitated by an illness or disability. The agent may also act on behalf of the principal in case the person is not readily available to sign off on financial or legal transactions. The power of attorney lapses when the creator dies, revokes it, or when it is invalidated by a court of law. A POA also ends when the creator divorces a spouse charged with a power of attorney or when an agent is not able to continue carrying out outlined duties.

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18.14 TYPES OF POWERS OF ATTORNEY

a) General Power of Attorney

The general power of attorney is a broad mandate that gives an agent a lot of power to handle the affairs of a principal. The agent or the person designated to act on behalf of the principal is charged with handling several tasks. The tasks include buying or disposing of real estate or even entering into contractual relationships on the principal's behalf.

b) Limited or Special Power of Attorney

An individual looking to limit how much the agent can do should choose limited or special power of attorney. Before signing to notarize a limited power of attorney, a person needs to be as detailed as possible about how much the agent should handle. If an individual is not clear what should fall under the special power of attorney, it is best to speak to a legal counsel.

c) Durable Power of Attorney

The durable type of power of attorney is only effective during the period a person wished to get someone else act on his or her behalf. A non-durable POA will end the moment it is revoked or when the expiration date specified arrives. However, what will happen in the event the agent becomes debilitated? Will the POA still be applicable? In such a case, the principal would prefer that the POA remains active even if he or she becomes unable to communicate. For example, if the principal becomes comatose, but would prefer that the spouse be the agent, it can be specified in the form of a durable power of attorney. The POA gives power to the spouse to make decisions even when the principal is comatose.

d) **Medical or Healthcare Power of Attorney**

If the principal becomes very ill, he or she reserves the right to decide the quality of care preferred. Medical or health care POA authorizes the agent to make decisions on behalf of the principal in case of a life-threatening illness. Most health POAs fall under the durable kind because they take into consideration the fact that the principal may be too sick to make their own decisions. In all the instances above, the principal should speak to a counsel before choosing an agent. In addition, it is best for the principal to get the counsel to walk him or her through every step of notarizing a power of attorney in order to understand what should go into the document.

How Power of Attorney Works

The principal can either download or buy POA templates. In the event the template is acquired through either one of the two methods, the principal should ensure they belong to the state of residence. POA documents are very important, and the principal should not assume that the documents acquired are of the correct kind. Verification of the POA documents is necessary before the POA process can begin. The best way for a principal to start the process is by finding a family law counsel in their state of residence. If the associated legal fees are way beyond what the principal can manage, there is the option of visiting a legal services office. Alternatively, the principal can go to the Legal Services Corporation website and communicate with a legal aide. Principals who are eligible will be attended for free. In many states, it is mandatory to get the principal's signature notarized. In some cases, the witness's signature must also be notarized. In addition, there are some legal provisos that are not generally applicable. For example, there is no standardized POA principal form. Procedures and laws vary based on the principal's residence. While the durable POA is widely accepted, there are powers the principal cannot delegate, such as amending or making a will, contracting a marriage, or casting a vote.

18.15 TAX PLANNING THROUGH A WILL

As we know, any gifts to charity or to surviving spouses or civil partners are free of tax. Also, every individual has their own nil rate band threshold. In addition, certain assets (business and farming assets for example) attract reliefs from tax. It does not make sense for assets or amounts that would not produce a tax bill to be given to beneficiaries who are tax-exempt beneficiaries.

For example, If business assets are given to a surviving spouse, two tax reliefs apply and so one is wasted. It would be better for assets that attract tax relief to be given to beneficiaries who do not. The correct wording in a Will can arrange this. However, you may want your spouse to inherit your business for example and so advice needs to be taken as to how you can arrange this whilst still making best use of all the tax reliefs available.

a) Tax Planning for the Creation of a Hindu Undivided Family through a Will

One of the important means of tax planning which can be adopted through a Will is the creation of a Hindu Undivided Family (HUF). Under the provisions of Section 64(2) where a member of a Hindu impresses his self-acquired property with the character of the joint family property, the income there from is to be clubbed with the income. This advantage can be overcome by proper tax planning by transfer of certain property in favour of the coparcenaries of a Hindu governed by the Mitakshara School of Hindu Law so that a separate Hindu undivided family comes into existence which is recognised as an independent and separate taxable entity under the Income Tax Law.

For example, let us assume that the 82-year old Mr F, wishes to certain property to his son Mr S and his wife and children. He can make a Will and transfer the property to the Hindu Undivided Family of his son Mr S in unequivocal terms that the property transferred would belong only to the Hindu undivided family of Mr S and not to the family individual members. On the demise of the testator, the property is bequeathed to the Hindu undivided family in the above case would belong to the HUF

which is a separate entity. This Hindu undivided family would be able to enjoy the separate exemption limit applicable to it the Finance Act for the time being in force.

b) **Tax Planning for Bequests to Minor Children or Grand Children through a Will** Under the provisions of Section 64(1) if a person makes a gift to his minor children, minor grandchildren (paternal side) or arising to the minor children or minor grandchildren then the income accrue grand (other than disabled children) as the case may be, would be clubbed with the income of the donor. This would not, however, be the case if a testator makes a bequest to his minor children or minor grandchildren through a Will. The reason is obvious. After the demise of the testator, the assets given to the minor child would result in separate funds of the child, income from which would not be clubbed once the minor attains majority. It is possible to avoid clubbing of income of the minor by tying the funds to a minor's trust based on the principles of a Supreme Court decision in CIT v. Mr Doshi, 1995211 AIR 1 (SC). Hence, a Will can be adopted as a proper device for the transfer of property by way of a bequest through a Will leading to a lot of tax saving.

c) **Tax Planning for Transfer of Funds to Wife by a Will**

During a taxpayer's lifetime any gifts made to one's wife or vice-versa, are liable to be included in the income of the donor under the provisions of Section 64(1). However, when bequests are made in favour of one's spouse through a Will, obviously there is no question of clubbing of income. This can result in a lot of tax saving. With the abolition of the estate duty, this device, as well as other modes of transfer of property through Wills, can be adopted.

d) **Tax Planning for Transfer to Daughter-in-law by a Will**

Under the provisions of Sections 64(1)(vi) and (vii) it is provided that where a transfer is made in favour of the daughter-in-law, either directly or for her benefit to the trustees of a trust, the income from the assets would be clubbed with the income of the donor. Hence, during one's

lifetime, it is not possible to either make gifts in favour of the daughter-in-law or transfer assets to her through the medium of a trust. This handicap can, however, be overcome through the Will. Thus, a bequest can be made in favour of one's daughter-in-law, so as to confer on her a one, after the testator's demise. There would not be any clubbing the income of the daughter-in-law with the income of the executor of the deceased person's estate after the testator's death.

e) **Tax Planning for a Discretionary Trust through a Will**

A discretionary trust can be created through a Will who could be charged to tax at normal rates. It is provided in clause (ii) of the first proviso to Section 164(1) of the IT Act, that if there is only one trust declared by a Will, then the income of the discretionary trust would be chargeable to income tax as if it were the total income of an individual. So, it's important to make sure that only one discretionary trust is created through the Will. A discretionary trust is normally liable to income tax at the maximum marginal rate of tax as per Section 164(1) of the Income Tax Act, 1961 but there are four specific exceptions to this provision, as contained in the first proviso to Section 164(1).

18.16 TAX PLANNING THROUGH TRUSTS

Trust tax planning is a strategy that involves the use of trusts to minimize tax liabilities, protect assets, and manage wealth distribution. Trusts can be structured in various ways to achieve different tax advantages, such as reducing estate taxes, avoiding probate, and providing for efficient wealth transfer. It is a crucial aspect of financial and estate planning that involves using trusts to minimize tax liabilities and maximize wealth preservation. A trust is a legal arrangement in which one party, known as the grantor or settlor, transfers assets to another party, known as the trustee, to hold and manage for the benefit of one or more beneficiaries. Trust tax planning encompasses the various strategies and considerations for establishing and managing trusts to achieve specific tax and financial objectives. Trusts can be used for various purposes, including

asset protection, income shifting, and charitable giving. There are some strategies that should be adopted while planning tax through Trusts that are:

a) Income Shifting Strategies

Income shifting is a tax planning strategy that involves transferring income- producing assets to individuals or entities in lower tax brackets. Trusts can be an effective tool for income shifting, particularly when the beneficiaries are in lower tax brackets than the grantor. For example, a grantor can establish a trust to benefit their children or grandchildren and transfer income-producing assets to the trust. The income generated by the trust assets may be taxed at the beneficiaries' lower tax rates. Grantor trusts, in which the grantor is treated as the owner of the trust assets for income tax purposes, can also be used for income shifting, depending on the grantor's tax situation.

b) Asset Protection Strategies

Asset protection is a key consideration in trust tax planning. By transferring assets to an irrevocable trust, a grantor can protect those assets from creditors and legal claims. Trusts can also provide protection in the event of divorce or other legal disputes. When selecting a trust for asset protection purposes, it is important to consider the specific terms of the trust and the laws of the jurisdiction in which it is established. Some jurisdictions offer greater asset protection benefits than others, and certain types of trusts may provide stronger protection than others.

c) Charitable Giving Strategies

Trusts can be an effective tool for charitable giving, providing both tax benefits and the opportunity to support charitable causes. Charitable remainder trusts (CRTs) and charitable lead trusts (CLTs) are two common types of charitable trusts. CRTs provide the grantor or other non-charitable beneficiaries with an income stream for a specified period, with the remainder of interest passing to charity. Conversely, CLTs provide an income stream to charity for a specified period, with the

remainder of interest passing to non-charitable beneficiaries. Both CRTs and CLTs offer income, estate, and gift tax benefits.

d) Estate Planning Strategies

Trusts are a fundamental component of estate planning, allowing individuals and families to tax-efficiently transfer wealth to future generations. Trusts can be used to minimize estate taxes, maximize wealth transfer, and provide for the management and distribution of assets according to the grantor's wishes. Trusts can also be used to avoid probate, which can be a lengthy and costly process. By carefully structuring and funding trusts, individuals and families can achieve their estate planning goals while preserving their legacy for future generations.

18.17 SUMMARY

In conclusion we can say that estate planning is an important aspect of financial planning that individuals should not neglect and by engaging in estate planning, individuals can ensure that their assets are distributed as per their wishes and minimize the tax liabilities and legal hassles for their heirs and beneficiaries. If you want your assets and your loved ones protected when you can no longer do it, you will need an estate plan. Without one your heirs could face big tax burdens and the courts could designate how your assets are divided and even who gets to raise your children. Estate planning is often thought of as a tool for the wealthy. But that isn't the case. It can be a useful way for you to deal with your assets and liabilities before and after you die. Estate planning is also a great way for you to lay out plans for the care of your minor children and pets, and to outline your wishes for your funeral and favourite charities. But don't confuse writing a will with estate planning he former is just one of the steps you'll need to take in the estate planning process. While you're at it, make sure you appoint a responsible executor and review your accounts on a regular basis to ensure you're getting the most bang for your buck and if we talk about power of attorney it is an authority imposed on an agent by the principal allowing the said agent to make decisions on his/her behalf. The agent can receive limited or absolute authority to act on the principal's behalf on

decisions relating to health, property, or finances. A POA is common when a person is incapacitated and unable to make their own decisions. An experienced attorney can help draft trust documents that accurately reflect the grantor's intentions, while a knowledgeable tax advisor can provide guidance on the tax implications of various trust structures. Ultimately, trust tax planning is a powerful tool for preserving and transferring wealth, and careful planning can help ensure that a grantor's legacy endures for generations to come.

18.18 GLOSSARY

- Tax planning: It means reduction of tax liability by the way of exemptions, deductions and benefits. Tax planning in India allows a taxpayer to make the best use of the various tax exemptions, deductions and benefits to minimize his tax liability every financial year.
- Power of attorney: A general power of attorney is one that allows the agent to make all personal and business decisions.
- Joint Owner: Joint ownership means that two or more people are the legal owners of the property. Usually, joint owners are liable for the whole of the payments for any joint loans secured on the property, and decisions about the property are made by all the joint owners.

18.19 SELF-ASSESSMENT QUESTIONS

Q1. Why there is need of tax planning through will?

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Q2. Explain briefly Administration of an estate?

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Q3. What do you mean by power of attorney?

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18.20 SUGGESTED READINGS

- "Why is estate planning important?" by PreetiZende.
- https://trustandwill.com/learn/what-is-estate-planning
- Estate Planning – How To Get Started article by ICICIDIRECT.COM
- How to set your estate plan up for success by David Peterson, "Head of Wealth Planning".
- Tax Planning through a will article by S K Rathi published in CAclubindia.com

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UNIT-IV **LESSON NO. 19**

TAX ESTATE AND ADVANCE FINANCIAL PLANNING

ADVANCE FINANCIAL PLANNING

STRUCTURE

19.1 Introduction

19.2 Objectives

19.3 Concept of Advance Financial Planning

19.4 Importance of Advanced Financial Planning

19.5 Key Components of Advanced Financial Planning

19.6 Establish Client Partner Relationships

19.7 Various Ways of Building Relationships With Clients

19.8 Analyse Client objectives, Need & Financial Situation

19.9 Client need analysis

- 19.9.1 Importance of Client Needs Analysis
- 19.9.2 Steps in conducting a Client Needs Analysis
- 19.9.3 Ethical considerations in Client Needs Analysis

19.10 Client Financial Analysis

19.11 Summary

19.12 Glossary

19.13 Self-Assessment Questions

19.14 Suggested Readings

19.1 INTRODUCTION

Financial plan for businesses is essentially a forecast of future performance. It most often involves estimating the capital requirements for achieving certain strategic goals. The plan is conducted after a business determines its objectives and a vision for the future. It's used for outlining and understanding the activities, resources, equipment and materials required for achieving these objectives. Furthermore, financial planning can also help determine the timeline for achieving these goals. Therefore, a financial plan is typically used as part of a business plan, during the development and start of a business. The plan is a crucial part of a business plan, as it can help determine the viability of the business. It helps understand the finances behind the strategy and the timeline for getting the business on its feet. But additionally, financial planning is required at later stages of business development. It can help define the actions the business can do in order to succeed. For instance, financial planning can be used when implementing a new strategy or acquiring new equipment. Financial planning is akin to charting a course for a long journey. Just as you wouldn't embark on a cross-country trip without a roadmap, you shouldn't navigate through life without a financial plan. However, what's often overlooked is the importance of planning well in advance. In this article, we will explore the compelling reasons why advance financial planning is crucial for your financial well- being.

19.2 OBJECTIVES

After reading this lesson, you are able to understand:

- Concept of Advance financial planning
- Client partner Relationship
- Various objectives of clients
- Client need analysis
- Client financial analysis

19.3 CONCEPT OF ADVANCE FINANCIAL PLANNING

In today's fast-paced world, achieving financial success requires more than just saving money. It demands a well-thought-out strategy that goes beyond the basics of budgeting and investing. Welcome to the world of Advanced Financial Planning, where we delve into the intricate details of managing your finances to ensure a secure and prosperous future. Advanced financial planning is a comprehensive approach to managing one's financial resources in order to achieve long term financial goals. This may include creating a budget, saving for retirement, investing in stocks or other securities, managing debt, and creating a plan to achieve financial independence. Additionally, it may also include more complex strategies such as tax planning, estate planning, and risk management. It is important to consult a financial advisor or professional to help create a plan that is tailored to your individual needs and goals. Advanced financial planning refers to a more intricate and comprehensive approach to managing one's finances and achieving specific long-term financial objectives. It's particularly important for individuals with significant assets, complex financial situations, and specific long-term goals. The objective is to ensure that your financial resources are managed efficiently to help you achieve your desired financial outcomes while minimizing risks. It goes beyond basic financial planning, which typically covers budgeting, savings, and debt management. Advanced Financial Planning (AFP) is defined as a corporate financing model that looks at the profit and loss account, the balance sheet and cash flows where the impact of all relevant business and value drivers is determined from a profit, expense, asset, financing or capital perspective and this in one coherent loop. The basis for a functioning AFP model is the identification of the relevant value drivers of an organization and the ability to understand sensitivities of these as well as the competence to create what-if scenarios around the key value drivers. Here are some key aspects of advanced financial planning:

- **Investment and Portfolio Management:** Advanced financial planning includes the development and management of an investment portfolio.

This often involves diversification across various asset classes, such as stocks, bonds, real estate, and alternative investments. The goal is to optimize returns while managing risk.

- **Retirement Planning:** This is a central component of advanced financial planning. It involves determining how much you need to save for retirement, selecting the right retirement accounts (e.g., IRA), and creating a distribution strategy during retirement to ensure your savings last.
- **Tax Planning:** Advanced planners look for strategies to minimize taxes, such as tax- efficient investing, taking advantage of tax-advantage accounts, and estate tax planning. This might involve working with a tax professional or financial advisor.
- **Estate Planning:** Planning for the transfer of assets and wealth to heirs and beneficiaries is a complex area. Advanced financial planning might involve setting up trusts, creating a will, and taking steps to reduce estate taxes.
- **Risk Management and Insurance:** Evaluating and managing risk is crucial. This includes not only life and health insurance but also assessing other risks such as disability, long-term care, and liability. Decisions regarding types and amounts of insurance are a part of advanced planning.
- **Income and Cash Flow Management:** Advanced planning often involves strategies to maximize income sources, including investments and retirement benefits. It also includes managing cash flow effectively, especially during retirement.
- **Education Planning:** If you have children, advanced planning might involve saving for their education expenses, potentially through tools like 529 savings plans.
- **Debt Optimization:** Managing debt effectively is a consideration. This could include strategies for paying down higher-interest debt and optimizing the use of low-interest debt for investments.

- **Charitable Giving:** If you have philanthropic goals, advanced planning can include setting up charitable foundations or trusts and identifying tax-efficient ways to give. Business and Succession Planning: If you own a business, advanced planning extends to business continuity, exit strategies, and ensuring a smooth transition to heirs or buyers.
- **Long-Term Care Planning:** Advanced financial planning often involves addressing the potential need for long-term care, considering the costs and insurance options. Advanced financial planning typically requires a higher level of expertise and often involves working with financial advisors, estate planning attorneys, tax professionals, and other specialists to develop and execute a comprehensive plan.

19.4 IMPORTANCE OF ADVANCED FINANCIAL PLANNING

Advanced Financial Planning empowers you to take control of your financial future, reduce stress, and achieve your goals and this stability and prosperity are not accidental they result from careful planning and execution of the finances. Here's why Advanced Financial Planning matters:

1. **Achieve Your Goals:** By setting clear financial goals and crafting a plan to achieve them, you increase your chances of realizing your dreams, whether it's buying a home, sending your children to college, or retiring comfortably.
2. **Secure Your Future:** Advanced Financial Planning ensures that you have a safety net in place for unexpected expenses, emergencies, and retirement. It helps you build a nest egg that can support you in your golden years.
3. **Minimize Financial Stress:** When you have a well-structured financial plan, you can navigate through life's ups and downs with confidence. This reduces financial stress and allows you to focus on what truly matters to you.

19.5 KEY COMPONENTS OF ADVANCED FINANCIAL PLANNING

Successful Advanced Financial Planning involves several critical components and each of them playing a vital role in the financial journey of every business. So, here are some key components that helps to understand how advanced planning for finances will lead to a successful business entity.

a. **Budgeting and Expense Tracking:** Creating a detailed budget and tracking your expenses is the foundation of Advanced Financial Planning. It helps you understand where your money goes and enables you to make informed decisions about spending.

b. **Debt Management:** Managing debt is crucial to financial success. Learn how to effectively manage and reduce debt while building wealth.

c. **Investment Strategy:** Dive into the world of investments, including stocks, bonds, real estate, and more. Understand how to build a diversified portfolio that aligns with your goals and risk tolerance.

d. **Retirement Planning:** Plan for retirement early to ensure you have the financial freedom to enjoy your golden years. Discover strategies to maximize your retirement savings.

e. **Tax Optimization:** Explore tax-efficient strategies that can help you save money and optimize your financial plan.

f. **Estate Planning:** Ensure that your assets are protected and distributed according to your wishes. Learn the importance of wills, trusts, and estate planning.

g. **Risk Management:** Understand various types of insurance and how they can protect you and your family from unexpected events.

19.6 ESTABLISH CLIENT PARTNER RELATIONSHIPS

You must have observed that when a company offers substandard customer service, they start losing business. This indicates that if you want to grow, you must connect better with clients and develop a long-term relationship

as only then you can get repeat business from them. When customers are satisfied, they are more likely to recommend your product or service to the people they know. To date, word-of-mouth marketing fetches excellent results, and that is why it is essential to build strong relationships with clients. When you are in the process of building your relationship with a client, there can be times when you have to go out of the way and oblige them. To meet the customer's requirements, you may have to offer them a customized solution or do something quite different from your core business. When you do so, the client is never going to forget your favour, and it may also open the path for some extra revenue for you. In this way, you may come across an opportunity that you didn't consider before. Just remember that you are getting paid handsomely for your extra efforts. When you are building your relationship with clients, you have to treat it just like other relationships. There is a need for courtesy, understanding, and kindness. You should treat the client as a person and show genuine concern if you want a long-lasting bond with the customer.

For example:

If the client has been unwell for a while, you should send an email and ask them about their welfare. It would make them feel that you think about them and mean well to them.

Skills For Developing Client Relationships.

There are certain skills that you must develop to build strong relationships with clients:

1. **Being patient:** For a salesperson, patience is the quality you must possess. There will be times when your client will get too demanding, but you have to exhibit your best behaviour and be patient. It will help you understand the customer's pain points and the situation better. If you lose your temper, you will be at a loss because many other businesses offer a product or service similar to yours.

2. **Paying attention:** Everyone likes getting attention, and this is one tactic that can make you get into your client's good books. You must try to pay attention to the client and listen actively to understand what they

need and the issues they are currently facing. When you know what they require, you can present your solution to them in such a way that they cannot say no. It will help you close deals faster.

3. **Being able to communicate well:** Like how communication is essential in every relationship, it is an integral part of a client relationship. You have to work towards honing your communication skills when you are a sales rep. While communicating with prospects you need to take care that they get impressed by you, and that would be like winning half of the battle. You should know what to say in which situation. Also, being readily available for the client will make them feel as though they are essential for you. It makes the clients more comfortable in sharing all the details. However, there is a boundary of professionalism and friendliness that you have to set.

4. **Managing time well:** When you get a lot of stuff done in a short period, you will impress your clients. Everybody is in a rush, and the fact that you value other people's time will further strengthen your relationship. You must learn how to allocate your time to each task to get more done in a short time.

5. **Being self-aware:** In building good customer relationships, you need to understand your own feelings. By being self-aware, you can decipher your feelings and emotions and determine their impact on your behavior. Here is how it works, suppose you had a rough day with a client, you would carry that mood to the next client meeting if you lack self-awareness. On the other hand, once you start understanding your own feelings, you may tell the client before getting started that you had a tough day, and if they find you a little off track, there is nothing in it about them.

6. **Being empathetic:** Getting into the other person's shoes to understand what they are feeling is a great way to build a strong relationship. If the client is in some trouble at work, take a minute to absorb their feelings. It is a much better option than behaving as if nothing happened. The client will build a stronger bond with you if you are empathetic.

7. **Being realistic and optimistic:** Add elements of realism and optimism to your sales approach to how to improve client relationships. Being realistic involves looking at the client's situation without bringing your solution into the scene. The next step would be to blow in some optimism by helping the customer visualize their pain points vanishing and what their situation looks like in the future. The last part involves selling, where you offer a way for the client to reach their desired destination.

19.7 VARIOUS WAYS OF BUILDING RELATIONSHIPS WITH CLIENTS

Building a strong relationship with your business clients earns their trust and re-engaging you will save their time and money. In order to build strong and lasting client relationships, they must be able to trust and rely on you as an expert. That's why it's crucial to maintain a policy of openness when it comes to your professional opinions and point of view regarding the best interests of the project. Effective client management is important when running a small business, and building and maintaining strong relationships with clients play a key role. If you have built a strong relationship with your client, they are more likely to engage with you on future projects and refer you to others. Building a strong relationship with your clients earns their trust and once a client knows that you are dependable and can successfully perform the tasks required for a project. Given below are certain ways to build strong client relationships use these to create positive and lasting relationships that will benefit your business.

1. **Communicate Effectively and Consistently:** Timely, efficient communication should be a priority. When everyone is busy focusing on getting work done, communication can fall by the wayside. That's why it's important to clearly and consistently communicate throughout the project. Make it clear from the beginning that you will work with your client to develop value statements that align with their business goals and that you will evaluate progress against these agreed-upon value statements as the project progresses. Of course, communication with a

single client should not consistently and unreasonably encroach on your personal time or negatively affect your productivity. However, being available demonstrates that your client's project and satisfaction are important to you. In addition to timely and thorough communication, you can also build a strong client relationship by making your clients feel comfortable being open and honest with you. They should feel that their ideas and concerns will be taken seriously**.**

2. **Be Positive:** As an independent professional, you carry a number of responsibilities. As stressed out or overwhelmed as you may feel, it's important to show a positive face to your clients. Exude the energy and confidence that you want your clients to feel about your work. Enthusiasm and zeal are attractive personality traits that people enjoy being around and that clients enjoy working with.

3. **Treat Your Client as an Individual:** While your relationship with your client is of a professional nature, acknowledging that you see them as a person that is, more than just a pay check can go a long way. The extent to which this personal connection is appropriate will vary depending on your industry, client type, and the individual client's personality. If you know your client is a parent, you may simply ask how their children are doing. If you have a closer relationship with your client, something more personal such as emailing them a news article about their favourite musician might be appropriate and appreciated.

4. **Share Your Knowledge:** If your client doesn't understand your area of expertise, they may feel ignorant about the intricacies of the process and therefore disconnected from the development of the project. This is your opportunity to share information that will help the client understand what you do, which will build trust and confidence in the process. Explaining to your client what you did, why you did it, and how you came to your decision will help them feel knowledgeable and in-the-loop.

5. **Be Open-Minded:** In order to build strong and lasting client

relationships, they must be able to trust and rely on you as an expert. That's why it's crucial to maintain a policy of openness when it comes to your professional opinions and point of view regarding the best interests of the project. It can be tempting to want to appear agreeable and avoid uncomfortable confrontation by telling a client what you think they want to hear or withholding your true opinion about their project. However, these practices are not only counterproductive, but can also damage your reputation, decreasing your chances of a lasting relationship. By confidently expressing your honest opinions, clients will respect your initiative and desire for excellence.

6. **Exceed Expectations:** One of the best ways to help build strong client relationships is to develop a reputation as an independent professional who delivers exceptional results. Make sure that you don't oversell yourself and promise unrealistic results. By setting reasonable expectations, you give yourself the opportunity to completely impress the client with the final project and position yourself as someone they would like to continue to work with.

7. **Understand Your Client's Goals:** To succeed, you'll need to understand your client on both a micro and macro level. On the micro level, you'll want to understand the goals and objectives for the project at hand. But on the macro level, you'll want to understand how this project fits into the organization as a whole, as well as any key details about the client's culture that might help you in your engagement. The ability to understand your client's goals will help to build a relationship of trust and mutual respect.

8. **Speak Your Client's Language:** Successful consultants can adapt to their client's style, formality, and preferred method of communication, instead of sticking only with the tools where they may feel most comfortable. **For example,** your client may prefer video meetings or choose to text message instead of email. Some individuals just want facts, while others are more conversational. The key is flexibility: don't

go into a conversation with a pre-determined dialogue, but have a set strategy of what you hope to learn in the interaction."

9. **Stay Humble:** You were hired for your expertise, but any good consultant knows that the client is the expert on their specific business. Maybe they know the best way to approach a key stakeholder, or have a specific insight into their market positioning that can help you achieve your project's objectives. Defer to your client as the expert on their specific company and line of business, remaining humble in your line of inquiry about how to best approach the problem and the solution in a way that will work for their company.

10. **Use Project Delivery Tools:** Organizing project delivery is key to making a positive impression on clients. Use tools that help you deliver your work professionally from beginning to end, such as a project proposal, contract, SOW, client reports, and a professional invoice. These tools can help increase your level of professionalism and business skills as well as provide transparency and tracking of your project. Consider your client and determine what would be valuable to them. It could be as simple as delivering the project in an aesthetically pleasing format, hand-delivering the materials and giving an in-depth walk through or demonstration, or including a small value-adding feature that enhances the finished results. For loyal clients, a token of appreciation and thanks after key business milestones or around the holidays can be an unexpected pleasure that strengths your professional relationship. The key is to find the opportunity to go above and beyond in a manner that your clients will appreciate.

11. **Develop Appreciation:** While establishing client boundaries is important, there are times when going above and beyond can help your business. Keep limits in place, but be on the lookout for moments when you can go the extra mile. If you've been in the business for years, it can be easy to get stuck with old habits. Instead, consider each client situation individually and don't be afraid to adjust your work processes.

Some clients may really value hands-on access and want to be included in each stage of your process, whereas others may simply prefer a written, detailed weekly summary of what you've accomplished. Remember, communication is key to establishing a trustworthy relationship; talk to your clients to get a feel for what they value most and then incorporate their preferences your workflow. A little bit of thoughtful listening can go far in building respect and appreciation.

12. **Ask for Feedback:** Asking for feedback provides your client an opportunity to express their opinion about how you delivered your services and recommend ways to improve. This will be valuable to you in building better relationships with other clients but also shows the client you ask how much you value their opinion and how much you value your quality of service. Create a survey through a platform like Qualtrics or send them a PDF or Word doc questionnaire that allows them answer specific questions and provide general feedback. After receiving it, follow up with a thank you and let them know you appreciate the time they spent providing it.

13. **Follow Up after Your Project Ends:** Staying in touch with clients even after your project ends is a great way to extend your relationship beyond your immediate project. Share thought leadership you create, let them know you have developed a new skill, inform them of a key accomplishment you recently had with another client. This is a great way to reinforce your value and set yourself up for future business.

19.8 ANALYSE CLIENT OBJECTIVE, NEED & FINANCIAL SITUATION

Clients need advice they can use. Usable advice is targeted, timely and relevant. The style of delivery, the timing of delivery and to whom the advice is delivered are genuinely more likely to be important to a client than whether every last point has been addressed, or whether the report fits the house style, or contains every single relevant case law reference. The analysis of a client's

financial goals and objectives must identify all factors to be integrated into the financial decision-making process. The client must play a key role in the establishment of the financial goals and objectives. Financial goals and objectives must be consistent with client values and attitudes about their personal life. Without this "buy-in" from clients they will most likely not make the commitments necessary to accomplish their life aspirations. The financial plan and investment policy statement should be the basis for a common understanding between client and financial advisor. Success in a drug discovery project can only be achieved if there is an understanding of client objectives, timing, and available funding to reach realistic and defined goals. Provider has the experience and expertise to plan projects that have a high likelihood of success for our clients. A commitment to your True North, a path we can find with your inspiration and our help. By collecting, reviewing all of the following documents you can begin the analysis:

- Investment Policy Statements.
- Applicable Will and Trust Documents (including amendments).
- Custodial and Brokerage Statements.
- Insurance Policies.
- Service Agreements with Investment Management Vendors.
- Information on Retained Money Managers.
- Last 2 Years Tax Returns.
- Closely Held Business Documents (including Valuations).
- Any Documents Pertaining to Client Assets and Liabilities.

In this step of the process, it is necessary to obtain a complete understanding of the client's current financial position, legal and regulatory constraints, current service providers and professional advisors, and investment risk/return profile. This understanding is obtained from an in-depth analysis of the current facts and circumstances pertaining to the funds to be invested.

19.9 CLIENT NEEDS ANALYSIS

Client Needs Analysis (CAN) is a systematic process used by financial advisors to assess a client's financial goals, risk tolerance, and current financial situation. It is crucial for creating customized financial plans and providing tailored advice to clients. Client needs analysis is especially crucial for financial advisors, as it helps them gain a comprehensive understanding of their clients' financial goals, risk tolerance, and personal circumstances. Financial advisors are responsible for conducting a thorough CNA, which helps them to understand their clients' unique needs and expectations. This understanding enables advisors to develop suitable financial plans and strategies that help clients achieve their financial goals.

For example: Life events, such as marriage, having children, or retirement, can significantly impact a client's financial needs and priorities.

19.9.1 Importance of Client Needs Analysis

Client needs analysis is important as it helps businesses understand their clients' requirements, which in turn enables them to provide personalized and effective solutions that meet client needs and increase satisfaction.

1. A thorough client needs analysis allows financial advisors to develop personalized financial plans that cater to the specific requirements of each client.

2. By gathering information about a client's income, expenses, assets, liabilities, and future goals, financial advisors can create customized strategies that reflect the client's current financial situation and their long-term aspirations.

3. Client needs analysis is essential for establishing trust between financial advisors and their clients by demonstrating a genuine interest in understanding a client's financial situation, advisors can build a solid rapport and foster long- term relationships.

4. Every individual has a different appetite for risk, and understanding

this enables financial advisors to recommend suitable investment strategies that balance potential returns with acceptable levels of risk.

5. Conducting regular client needs analysis allows financial advisors to stay informed about any changes in their clients' financial situations or goals.

6. Another key aspect of client needs analysis in the context of financial advisory services is the ability to assess a client's risk tolerance accurately.

19.9.2 Steps in Conducting a Client Needs Analysis

To conduct a client needs analysis, businesses must identify their client's goals, preferences, and challenges. This can be done through surveys, interviews, or observation. It can be conducted by sales professionals, customer service representatives, and other individuals who interact with clients. The goal is to gather information that helps the organization offer personalized solutions. The following are the steps involved in conducting a client needs analysis.

1. **Identifying Client's Financial Goals:** Financial goals are specific, measurable objectives that clients aim to achieve within a certain time frame. Short-term goals typically focus on immediate needs, such as paying off debt or saving for an emergency fund, while medium-term goals may involve saving for a home or funding education. Long-term goals often include retirement planning and wealth management.

2. **Assessing Client's Financial Situation:** Evaluating a client's financial situation involves analysing their current financial status, income, expenses, and asset allocation. This assessment helps financial advisors identify any gaps or areas of concern in the client's financial plan, enabling them to offer tailored solutions.

3. **Evaluating Client's Risk Tolerance:** Risk tolerance encompasses a client's risk capacity, attitude, and perception. Financial advisors must assess their clients' willingness and ability to take on risk when investing,

as this informs the selection of appropriate financial products and investment strategies.

19.9.3 Ethical Considerations in Client Needs Analysis

As we know ethics are most important factor in every aspect and when we talk about finance ethics must be considered and the financial advisors are required to follow certain ethical considerations when conducting client needs analysis.

1. **Maintaining Confidentiality:** Financial advisors have an ethical duty to maintain the confidentiality of their clients' personal and financial information. This trust is essential for establishing and maintaining strong client-advisor relationships.
2. **Managing Conflicts of Interest:** Financial advisors must prioritize their clients' best interests and actively manage any conflicts of interest that may arise. This includes disclosing any potential conflicts and ensuring objective, unbiased advice is provided.
3. **Providing Transparent and Objective Advice:** Financial advisors should provide transparent and objective advice to their clients, ensuring that all recommendations are based on the client's unique needs and goals. This transparency helps to build trust and confidence in the advisor-client relationship.

19.10 CLIENT FINANCIAL ANALYSIS

Evaluation of the client's financial situation forms the foundation for the recommendations that a planner will ultimately make. Thorough analysis of the client's current financial condition also serves the planner in several ways. It increases the efficiency and accuracy of recommendations and should provide increased conformity across clients and planners in an office for both accuracy and compliance concerns. As a business advisor, you need to assess the financial health of your clients to provide them with effective guidance and solutions. Financial health is the ability of a business to generate cash flow,

manage debt, and sustain growth. The purpose of creating and evaluating financial statements is to measure the extent to which a given client compares with income and asset peers. There are innumerable risks clients face as they work to achieve their objectives, some of which can be ameliorated with the use of insurance. To measure and evaluate these aspects of your clients' performance, Here are some steps and tools you can use to conduct a comprehensive financial health assessment.

1. **Review financial statements:** The first step is to review the financial statements of your clients, such as the income statement, balance sheet, and cash flow statement. These documents provide information on the revenues, expenses, assets, liabilities, and cash flows of the business. You can use ratios and indicators to analyze the profitability, liquidity, solvency, and efficiency of your clients. **For example,** you can use the net profit margin, current ratio, debt-to-equity ratio, and inventory turnover ratio to assess different aspects of financial health.

2. **Compare with industry benchmarks:** The next step is to compare the financial performance of your clients with the industry benchmarks and standards. This will help you to identify the strengths and weaknesses of your clients relative to their competitors and peers. You can use sources such as industry reports, trade associations, and databases to find relevant benchmarks and averages. **For example,** you can use the industry average net profit margin, current ratio, debt-to-equity ratio, and inventory turnover ratio to evaluate how your clients are performing compared to their industry.

3. **Conduct a SWOT analysis:** The third step is to conduct a SWOT analysis of your clients. SWOT stands for strengths, weaknesses, opportunities, and threats. This is a strategic tool that helps you to identify the internal and external factors that affect the financial health of your clients. You can use the financial statements, ratios, and benchmarks as inputs for the SWOT analysis. **For example,** you can list the financial strengths and weaknesses of your clients, such as high profitability, low

liquidity, or high debt. You can also list the financial opportunities and threats that your clients face, such as new markets, regulations, or competition.

4. **Identify risks and opportunities:** The fourth step is to identify the risks and opportunities that your clients face based on the SWOT analysis. Risks are the potential events or situations that could negatively affect the financial health of your clients. Opportunities are the potential events or situations that could positively affect the financial health of your clients. You can use a risk matrix to prioritize the risks and opportunities based on their likelihood and impact. **For example,** you can rank the risks and opportunities from high to low based on how likely they are to occur and how much they would affect the financial performance of your clients.

5. **Recommend actions and solutions:** The final step is to recommend actions and solutions to your clients based on the risks and opportunities identified. Actions are the specific steps or measures that your clients can take to improve their financial health. Solutions are the products or services that you can offer to your clients to help them achieve their financial goals. You can use a SMART framework to make your recommendations specific, measurable, achievable, relevant, and time-bound. **For example,** you can suggest actions and solutions such as reducing costs, increasing sales, refinancing debt, or using accounting software to your clients.

6. **Monitor and evaluate results:** The last step is to monitor and evaluate the results of your recommendations. You need to track the progress and performance of your clients over time to see if they are achieving their financial goals and improving their financial health. You can use key performance indicators (KPIs) to measure and report the outcomes and impacts of your actions and solutions. You can also use feedback and surveys to collect the opinions and satisfaction of your clients. **For example,** you can use KPIs such as net profit margin, current ratio,

debt-to-equity ratio, and inventory turnover ratio to monitor and evaluate the financial health of your clients.

19.11 SUMMARY

In the journey of life, financial planning is the compass that guides you toward your goals and helps you navigate the challenges that lie ahead. However, the significance of planning in advance cannot be overstated. It empowers you to build a financial safety net, achieve long term goals, reduce stress, maximize tax efficiency, plan your estate, adapt to life changes and secure a comfortable retirement. So, take the first step today and embark on the path of advance financial planning for a more secure and prosperous future. With advance financial planning conducting a thorough Client Needs Analysis is vital for developing customized financial plans and strategies that align with clients' unique goals and risk tolerance. By understanding their clients' needs, financial advisors can help them make informed decisions and achieve their financial objectives. Financial advisors play a crucial role in conducting CNAs and using the insights gained to create tailored financial plans for their clients. By prioritizing their clients' best interests and adhering to ethical standards, financial advisors can foster strong, trust-based relationships that ultimately lead to financial success.

19.12 GLOSSARY

- **Client:** A client refers to a certain type of customer who purchases professional services from a business.
- **Advanced Financial Planning:** AFP is defined as a corporate financing model that looks at the profit & loss account, the balance sheet and cash flows where the impact of all relevant business and value drivers is determined.
- **Evaluation:** It is the process of examining the performance of an organization, program, project, policy, or any other intervention to determine its relevance, adequacy, effectiveness, efficiency, and progress for the purpose of identifying areas for improvement.

- **Retained money:** Retention money is described as the sum of money held by the employer as a safeguard for any defective or non-conforming work by the contractor.

19.13 SELF-ASSESSMENT QUESTIONS

Q1. What is the primary goal of Advanced Financial Planning?

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Q2. How to conduct Client need analysis?

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Q3. What are the various skills needed to develop relationship with clients?

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19.14 SUGGESTED READINGS

- The Imperative Need for Advance Financial Planning by Garima Malhotra.
- Client Needs Analysisby True Tamplin, "finance strategist".
- Analysing and Evaluating the Client's Current Financial Status by Charles R.Chaffin EdD,onlinelibrary.wiley.com.
- https://www.linkedin.com/advice/how-do-you-assess-financial-health-your- clients.
- Effective Client Management in Professional Services: How to Build Successful Client Relationships by Jack Berkovi.

- The Art of Client Service by Robert Solomon.
- https://salesblink.io/blog/build-client-relationships.
- Advanced Financial Planning: Your Path to Financial Success by Leetamisha: A digital marketing agency.

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UNIT-IV **LESSON NO. 20**

TAX ESTATE AND ADVANCE FINANCIAL PLANNING

DEVELOPING, IMPLEMENTING AND MONITORING OF FINANCIAL PLAN

STRUCTURE

20.1 Introduction

20.2 Objectives

20.3 Developing Financial Plan

20.4 Things to be Considered while Developing Financial Plan

20.5 Implementating Financial Plan

20.6 Process of Financial Plan Implementation

20.7 Monitoring of Financial Plan

20.8 Framework of Establishing Monitoring of Financial Plan

20.9 Various Techniques of Monitoring Financial Plan

20.10 Summary

20.11 Glossary

20.12 Self-Assessment Questions

2013. Suggested Readings

20.1 INTRODUCTION

Financial planning is essential for achieving financial stability and success. Financial planning involves the strategic management of financial resources to achieve specific financial goals. It encompasses saving, investing, budgeting, and risk management, among other aspects. A well-executed financial plan helps individuals attain financial security and build wealth over time. Proper financial planning allows individuals to make informed decisions about their financial future. It helps in managing income, building assets, and ensuring financial stability. Developing good financial habits and staying committed to the financial plan can help individuals overcome obstacles and stay on track with their goals. Proper financial planning offers numerous benefits, such as increased financial security, reduced stress, and improved quality of life. By following a well-structured financial plan, individuals can achieve their financial goals and enjoy the rewards of their hard work and dedication. It requires ongoing learning and adaptation to changing circumstances, market conditions, and personal needs. Embracing a growth mindset and staying informed about financial trends and developments can help individuals make informed decisions and continuously improve their financial plans. Regularly reviewing and evaluating the progress of your financial plan to ensure that you are on track to meet your financial goals. It involves analyzing your income, expenses, assets, and debts to determine if adjustments are needed to keep you on track. It can help you feel more confident about navigating bumps in the road like, a recession or historic inflation. According to Charles Schwab's 2023 Modern Wealth Survey, Americans who have a written financial plan feel more in control of their finances compared with those without a plan. Once your basic needs and short-term goals have been addressed, a financial plan can also help you tackle big-picture goals. Thoughtful investing, for example, can help build generational wealth, and careful estate planning can ensure that wealth gets passed down to your loved ones. Anyone who wants to achieve their financial goals can benefit from financial plan development, regardless of their income or assets. Whether you are just starting out in your career or preparing for retirement, having a well- thought-out financial plan can help you achieve your goals and secure

your financial future and even the implementation of financial plan is important because it allows individuals and businesses to execute their financial plans and take concrete steps toward achieving their financial objectives. Even various times it is recommended to monitor your financial plan at least once a year. However, if there are significant changes in your life, such as a change in income, a new job, or a major purchase, you should review your plan more frequently.

20.2 OBJECTIVES

After reading this lesson, you are able to understand:

- Concept of Financial Plan Development
- Concept of Financial Plan Implementation
- Concept of Financial Plan Monitoring

20.3 DEVELOPING FINANCIAL PLAN

This Financial Guide tells you how to begin the financial planning process. It provides worksheets to help you find out where you are financially and where you want to be in the future. It will help you identify your goals, determine your net worth and cash flow, plan to achieve your goals as well as begin to put your plan into action. Financial security derives not only from acquiring more money, but from planning. A solid financial plan can alleviate financial worries about the future and ensure that you will meet your financial goals-whether they relate to retirement, asset acquisition, education, or just vacations. This Financial Guide allows you to take the first step towards a solid plan. By following the instructions and guidelines contained in it, you can find out where you are now and how you can put your plan into action. There are many ways to approach setting up a financial plan. The one outlined in this guide is just one of a number of approaches. Your financial advisor can assist you in setting up the financial plan that best meets your particular situation and needs. Financial plan development is the process of creating a comprehensive financial roadmap that outlines your short and long-term financial goals, and the strategies and tactics required to achieve them. It

involves analysing your current financial situation, identifying potential risks and challenges, and developing a plan to achieve your financial goals. A well-designed financial plan takes into consideration your income, expenses, debts, savings, investments, and other financial aspects of your life. It includes strategies for managing cash flow, minimizing taxes, investing for retirement, protecting your assets, and achieving other financial objectives. The process of financial plan development may involve working with a financial advisor or planner, who can help you create a plan that aligns with your unique needs and circumstances.

20.4 THINGS TO BE CONSIDERED WHILE DEVELOPING FINANCIAL PLAN

1. **Consider your needs and obligations at each life stage:** When you begin to consider building your financial plan, the first area you should take into account is your individual needs and requirements and how these are likely to change throughout your lifetime. Of course, not all of these will have a monetary value, but it is likely that most will and so considering them will give you an indication of your financial needs throughout life.

   Some of the immediate questions you can consider include:

   - How long do I have left on my mortgage?
   - What are my monthly living expenses and how will these change over time?
   - What other expenses will I have throughout my life?
   - How long will my children and/or grandchildren be dependent on me financially?
   - Do I want to set aside some money for later-life care?

   Of course, there will be additional questions to consider; however, by the end of these considerations you will have a comprehensive outline of your financial needs and obligations for the short, medium and long

term. Once you have considered these areas, you can begin to factor in aspirations which are orientated around your desired lifestyle at each life stage. These could include retirement length and location, or other costs such as holidays and vehicles. It is important to realise that for your plan to work you must consider the basics prior to lifestyle aspirations otherwise you could find yourself unprepared, with a financial shortfall in later life.

2. **Create specific and realistic goals for the short, medium and long-term:** After identifying your needs and financial obligations, you should begin to identify some financial goals. As you will have noticed above, your focus will change throughout life and, as such, your goals should be orientated around the short, medium and long- term. You should also ensure that the SMART goals given below will be easier to benchmark against.

- Specific
- Measurable
- Achievable
- Realistic
- Timely (or Time bound)

Examples of possible goals include:

Short – To put £5000 in your personal pension per annum, for the next 5 years.

Medium – To retire with a net income of £36,000 in today's terms.

Long – To be able to donate £10,000 to charity as part of your will.

Planning these in advance will provide structure to your financial plan and will allow you to focus on specific financial planning solutions to meet your goals over time.

3. **Adjudge whether your protection arrangements are sufficient:** Unfortunately, life can include situations which cause financial worry

for you and your dependents. Whether that is the loss of your job, incapacitation, illness, or even death, it is important to be protected against unforeseen circumstances. You should begin by considering the following fundamental questions:

- How long would you be able to manage without a job before your finances were seriously damaged?
- Would you be able to afford long term care if you became seriously ill, or incapacitated?
- Could your dependents cope financially if you were to become incapacitated for an extended period of time? What if you were to die prematurely?

Thankfully, there are a number of protection or personal insurance policies that can help safeguard you against the unthinkable. These insurance policies include:

- Life assurance
- Income protection
- Critical illness cover
- Private medical insurance

Having the correct protection in place will provide you with peace of mind and is a fundamental component of any financial plan.

4. **Research the tax allowances and reliefs available to you:** Often, you can mitigate some of your tax liability by researching the tax allowances and reliefs available to you and diversifying your assets to benefit from them. It is important to be careful, however, as many people attempt tax planning on their own and end up making mistakes that can cost them vast sums of money. Often, the help of a professional, expert financial planner, and the resources available to them, can prove invaluable – they are able to distribute your assets to utilise the tax allowances and reliefs available to you, mitigating your overall tax liability where possible, all whilst adhering to your financial plan.

5. **Think about which life events will require you to review your plan:** It will not come as a surprise that your priorities and requirements will change throughout your lifetime and what is important at present can seem insignificant in later life. Therefore, it is important you create a plan that is adaptable to potential changes. But, have you thought about this? Are you aware of when your financial plan will need to be reviewed and adjusted to reflect changes in your circumstances? If you haven't already considered these events, then it is important that you do so before you complete your financial plan. The life events which may cause you to review your plan include:

- Marriage or Divorce
- Children and/or Grandchildren
- Inheritance
- Retirement
- Death of your spouse
- Later life care

20.5 IMPLEMENTING FINANCIAL PLAN

Financial plan implementation is the process of putting into action the strategies and steps outlined in a financial plan to achieve specific financial goals. It involves taking concrete steps towards achieving financial objectives, monitoring progress, and adjusting the plan as needed. It involves executing the action steps outlined in the financial plan. This may include actions such as opening and funding investment accounts, paying off debt, creating a budget, increasing savings, or reducing expenses. It may also involve seeking out professional advice, such as from a financial advisor or tax professional. The implementation process typically requires discipline, focus, and commitment to the long- term goals outlined in the financial plan. By following the plan and taking consistent action, individuals and businesses can improve their financial situation and work towards achieving their financial objectives.

20.6 PROCESS OF FINANCIAL PLAN IMPLEMENTATION

Taking a strategic approach to managing your finances is a good way to keep tabs on how you're doing, but even the most organized person doesn't always take the time to make an annual financial plan and map out what they hope to achieve financially over the next 12 months. Even if you feel fairly confident about how you've been handling your finances so far, understanding how you can use an annual financial plan to your advantage can help you make smarter decisions with your money going forward.

1. Identifying Financial Goals

a. **Short-Term Goals:** Short-term financial goals are those you aim to achieve within one year. Examples include building an emergency fund, paying off high-interest debt, or saving for a vacation. Identifying short-term goals can help you establish a strong foundation for financial stability.

b. **Medium-Term Goals:** Medium-term goals are typically achievable within one to five years. These might include saving for a down payment on a house, funding a child's education, or starting a business. Medium-term goals bridge the gap between short-term and long-term financial objectives.

c. **Long-Term Goals:** Long-term financial goals are those that take more than five years to achieve. Retirement planning, investing in real estate, and building a substantial investment portfolio are common long-term goals. Identifying these goals will guide your overall financial plan.

2. Assessing the Current Financial Situation

a. **Net Worth Calculation:** To assess your current financial situation, start by calculating your net worth. This involves subtracting your total liabilities (debts) from your total assets (savings, investments, property). Knowing your net worth can provide a clear picture of your financial health and help you track progress over time.

b. **Cash Flow Analysis:** Performing a cash flow analysis involves examining your income and expenses to determine whether you have a positive or negative cash flow. This analysis is essential for identifying areas where you can cut expenses or increase income to improve your financial situation.

c. **Debt Management:** Managing debt is a crucial aspect of financial plan implementation. Create a debt repayment strategy that prioritizes high-interest debt, such as credit cards, while also considering other obligations like student loans or mortgage payments.

3. **Creating a Budget**

a. **Fixed Expenses:** Fixed expenses are recurring costs that remain relatively constant, such as rent or mortgage payments, utilities, and insurance premiums. When creating a budget, account for these expenses first to ensure they are covered each month.

b. **Variable Expenses:** Variable expenses are those that fluctuate each month, such as groceries, entertainment, and transportation costs. Allocating a portion of your budget for variable expenses allows for flexibility in spending while still maintaining control over your finances.

c. **Savings and Investments:** Setting aside a portion of your budget for savings and investments is crucial for achieving long-term financial goals. Establish a regular savings habit and consider investing in a diversified portfolio to grow your wealth over time.

4. **Developing a Risk Management Plan**

a. **Insurance Needs:** Insurance plays a vital role in managing financial risks. Evaluate your insurance needs, including life, health, disability, and property insurance, to ensure that you and your family are protected in case of unexpected events.

b. **Emergency Fund Establishment:** An emergency fund is a critical component of any financial plan. Aim to save three to six months' worth

of living expenses in a readily accessible account to cover unexpected expenses, such as medical emergencies or job loss.

5. **Investment Planning**

a. **Asset Allocation:** Asset allocation involves dividing your investments among different asset classes, such as stocks, bonds, and cash, to balance risk and potential returns. Develop an asset allocation strategy that aligns with your risk tolerance and financial goals.

b. **Diversification:** Diversification is the practice of spreading your investments across various assets to minimize risk. By investing in a range of assets, you can reduce the impact of poor performance in a single investment.

c. **Tax-Efficient Investing:** Tax-efficient investing involves structuring your investments to minimize the impact of taxes on your returns. Consider tax- advantaged accounts, such as IRAs or 401(k)s, and tax-efficient investment products like index funds or municipal bonds to optimize your after-tax returns.

6. **Retirement Planning**

a. **Estimating Retirement Needs:** Determining how much money you will need for retirement is essential for creating a long-term financial plan. Consider factors such as living expenses, healthcare costs, and desired lifestyle to estimate the amount you will need to save for a comfortable retirement.

b. **Retirement Savings Strategies:** Develop retirement savings strategies that align with your financial goals and time horizon. Consider employer-sponsored retirement plans, individual retirement accounts (IRAs), and other investment vehicles to build your retirement nest egg.

c. **Social Security and Pension Considerations:** Social Security and pension benefits can provide additional income during retirement. Understand how these benefits work, when you can begin receiving them, and how they will factor into your overall retirement income.

7. **Estate Planning**

a. **Wills and Trusts:** Estate planning is essential for ensuring that your assets are distributed according to your wishes upon your death. Creating a will or establishing a trust can provide clear instructions for the distribution of your estate.

b. **Power of Attorney:** A power of attorney document grants a designated individual the authority to make financial and legal decisions on your behalf in the event of incapacity. This document is an essential component of a comprehensive estate plan.

c. **Beneficiary Designations:** Ensure that your beneficiary designations on retirement accounts, life insurance policies, and other assets are up to date. These designations determine who will receive the proceeds of these accounts upon your death.

20.7 MONITORING OF FINANCIAL PLAN

Financial plan monitoring is the process of regularly evaluating and adjusting one's financial plan to stay on track with financial goals and objectives. This crucial aspect of personal finance management ensures that individuals and families can meet their financial goals, adapt to changes in their circumstances, and make informed decisions about their financial future. Monitoring a financial plan is essential because it helps identify potential issues before they become major problems, ensures that financial goals are being met, and provides an opportunity to adjust strategies as needed. In addition, ongoing monitoring allows individuals to make better financial decisions and gain a better understanding of their financial situation. The primary objectives of financial plan monitoring include tracking progress towards financial goals, identifying areas for improvement, ensuring compliance with legal and tax requirements, and adapting to changes in personal circumstances or market conditions. Monitoring the performance of savings and investment accounts helps to ensure that they are meeting their intended objectives and allows for adjustments in investment strategies as needed. Even Monitoring one's budget

is also essential for identifying overspending, making necessary adjustments, and staying on track with financial goals.

20.8 FRAMEWORK OF ESTABLISHING MONITORING OF FINANCIAL PLAN

To effectively monitor a financial plan, it is essential to establish a robust monitoring framework that includes setting goals, identifying key performance indicators (KPIs), selecting appropriate tools and software, and determining the frequency of monitoring and review.

1. **Setting Financial Goals and Objectives:** Clearly defined financial goals and objectives provide a roadmap for financial success and serve as a basis for monitoring progress. Goals should be specific, measurable, achievable, relevant, and time-bound (SMART).
2. **Identifying Key Performance Indicators (KPIs):** KPIs are measurable values that indicate progress towards financial goals. Examples of KPIs include net worth, savings rate, debt-to-income ratio, and investment portfolio performance.
3. **Selecting Appropriate Monitoring Tools and Software:** There are many financial tools and software available to help monitor and manage personal finances. Selecting the right tools depends on individual preferences, budget, and the complexity of one's financial situation.
4. **Determining the Frequency of Monitoring and Review:** The frequency of financial plan monitoring will depend on individual circumstances, goals, and preferences. At a minimum, it is advisable to review and update the financial plan annually, but more frequent monitoring may be necessary to track progress and make adjustments as needed.

20.9 VARIOUS TECHNIQUES OF MONITORING FINANCIAL PLAN

When monitoring your financial plan, you should look at your income,

expenses, savings, investments, debts, and any changes in your personal circumstances. You should also evaluate whether you are on track to meet your financial goals and make any necessary adjustments to your plan. There are several techniques and strategies that can be employed to effectively monitor a financial plan that are given below:

1. **Regular Reviews of Financial Statements:** Financial statements provide valuable insights into one's financial health and progress towards goals. These include:

   a. **Income Statement:** An income statement provides an overview of income and expenses over a specific period. Regularly reviewing income statements helps to identify trends, detect overspending, and track progress towards budgeting goals.

   b. **Balance Sheet:** A balance sheet provides a snapshot of one's assets, liabilities, and net worth at a specific point in time. Regularly reviewing balance sheets helps to track changes in net worth, evaluate the effectiveness of debt management strategies, and assess overall financial health.

   c. **Cash Flow Statement:** A cash flow statement provides a detailed account of cash inflows and outflows over a specific period. Regularly reviewing cash flow statements helps to ensure that sufficient cash is available to meet financial obligations and to identify opportunities to optimize cash management strategies.

2. **Tracking KPIs and Benchmarks:** Regularly tracking KPIs and comparing them to established benchmarks helps to ensure that the financial plan is on track and allows for adjustments as needed.

3. **Comparing Actual Performance to Projections:** Comparing actual financial performance to projections helps to identify areas where the financial plan may need adjustments and provides an opportunity to update the plan based on current circumstances.

4. **Assessing Progress towards Financial Goals:** Regularly assessing

progress towards financial goals helps to ensure that the plan is working effectively and provides motivation to stay committed to achieving those goals.

5. **Evaluating the Impact of External Factors:** Monitoring the impact of external factors, such as changes in market conditions, tax laws, or personal circumstances, is crucial for adapting the financial plan as needed to maintain its effectiveness.

20.10 SUMMARY

Financial plan development is an essential process for individuals and businesses to achieve their financial goals and secure a stable financial future. By setting clear objectives, gathering and analysing financial data, creating a budget, implementing saving and investment strategies, managing risks through insurance, planning for taxes, retirement, and estate, it is possible to establish a comprehensive and adaptable financial plan. Regularly monitoring and reviewing the plan ensures that it remains aligned with changing financial goals and circumstances. Working with a trusted financial professional can provide valuable guidance and support throughout the financial planning process, helping to navigate complexities and make informed decisions. Ultimately, a well-crafted financial plan serves as a roadmap to financial success and long-term security. The importance of disciplined financial plan implementation cannot be overstated. By proactively planning and adjusting your financial plan, you can work towards achieving your financial goals and enjoying long-term financial stability. Remember, financial plan implementation is an ongoing process that requires regular monitoring, adjustments, and collaboration with financial professionals to ensure success. Financial plan monitoring is an essential component of successful personal finance management. By regularly reviewing and adjusting the various components of a financial plan, individuals can ensure that they are on track to achieve their financial goals, adapt to changes in their circumstances or market conditions, and make informed decisions about their financial future. Establishing a robust monitoring framework, employing effective monitoring techniques and strategies, and maintaining ongoing

communication and collaboration among stakeholders are all crucial for ensuring long- term financial success.

20.11 GLOSSARY

- Monitoring: It involves paying close attention as it is a type of systematic observation, like the monitoring of criminals by the police. Kids who are up to something don't like their parents' monitoring their every move.
- Debt management: It is a way to get your debt under control through financial planning and budgeting. The goal of a debt management plan is to use these strategies to help you lower your current debt and move toward eliminating it.
- Asset allocation: It involves dividing your investments among different assets, such as stocks, bonds, and cash. The asset allocation decision is a personal one. The allocation that works best for you changes at different times in your life, depending on how long you have to invest and your ability to tolerate risk.
- Power of attorney: The term refers to a legal authorization that gives a designated person the power to act for someone else as such it gives the agent or attorney-in-fact the authority to act on behalf of the principal.

20.12 SELF-ASSESSMENT QUESTIONS

Q1. What is Financial Plan Development?

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Q2. Discuss the process of Financial Plan Implementation.

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Q3. Describe various techniques of monitoring Financial plan.

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20.13 SUGGESTED READINGS

- https://lffinancialplanning.co.uk/5-considerations-when-developing-your- financial-plan
- Financial planning by True Tamplin CEO of Up Digital
- http://www.cmmtax.com/resources/guides/life-events/developing-financial-plan
- The implementation of financial planning and cost accounting instruments in start-ups by Markus Pfu tzenreuter. “journal of Junior Management Science”

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