# HOW TO GROW MONEY

*(Lessons on Financial Growth and Stability)*

**The Institute of Chartered Accountants of India**

*(Set up by an Act of Parliament)*

**New Delhi**

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Investing strategies and actions discussed in our publications may not be suitable for you. You must make your own investment decisions in the light of your own circumstances.

# FOREWORD

Chartered accountants play a critical role in diverse areas related to accounting, finance, laws, systems, business strategy and so on. With their spread in every nook and corner of country, they also play a critical role in the inclusive growth by extending their financial services to rich and poor. Through careful financial planning both rich and poor can build their financial corpus to meet their future needs. In fact, in present dynamic climate and future uncertainties, financial planning is the need for every individual.

Financial Planning provides direction and meaning to individual's financial decisions. It is the long-term process of wisely managing one's finances so that one can achieve the desired goals and dreams, while at the same time negotiating the financial barriers that inevitably arise in every stage of life.

Financial planning begins with understanding needs and goals of an individual.

Understanding those help in strategising finances and enable individuals and families to build their assets and also try to balance their budget, savings for their children education, healthcare and for their retirement. Financial planning is an ongoing process; it changes at different stages of life with the changes in factors such as risk bearing capacity and earnings. Moving in unplanned manner and bad financial decisions can be a big drain on our finances and therefore financial planning helps in identifying and plugging financial leaks.

I am glad that the Committee on Financial Markets and Investors' Protection of the Institute of Chartered Accountants of India is bringing out a publication on "How to grow Money - Lessons on Financial Growth and Stability". This publication covers various facets of financial planning in a nutshell and I hope it shall serve as a useful guide for investors and professionals. This publication provides an overview in a lucid and concise manner of the important information one should understand while taking financial planning decisions. This booklet also aims to provide informative and educative material to a common man.

I take this opportunity to congratulate CA. Rajkumar S. Adukia, Chairman, and the entire team of Committee on Financial Markets and Investors' Protection for their initiatives and endeavours.

**CA. Subodh K. Agrawal**
*President*
*The Institute of Chartered Accountants of India*

# PREFACE

One of the most important concepts of Financial Planning is investing wisely. This means distributing your money across a range of investments. One should avoid putting all his hard earned money in to one type of investment. One should also be conscious while investing in luring schemes. An individual investor should also work out how much risk he is prepared to take. Some investments may be volatile in the short-term but provide sound returns over the long run.

One of the keys to financial planning is to work out a right strategies for an individual.

The purpose to bring out this publication is to present the salient features and the relevance of Financial planning in an individual's life span. It also covers various types of capital market investments, insurance policies, Government Schemes etc.

The Committee in its endeavour has taken many initiatives on the front of investor education and awareness and one amongst them is the release of this publication. I also wish to place on record my sincere gratitude to CA. Subodh Kumar Agrawal, President, ICAI and CA. K. Raghu, Vice - President, ICAI for their vision and support to the Committee on Financial Markets and Investors' Protection.

I would also like to thank CA. Jay Chhaira, Vice-Chairman CFMIP and all other members of CFMIP Committee, CA. Pankaj Inderchand Jain, CA. Sanjeev Maheshwari, CA. S. Santhana Krishnan, CA. Anuj Goyal, CA. Naveen N. D. Gupta, Shri Sidharth K. Birla, Shri Sunil Kanoria, CA. Sharad Kabra, CA. Vikash Jain, CA. Murmuria Bijay and CA. Shyam Lal Agarwal who have extended their support and encouragement in all Committee activities.

I sincerely appreciate the efforts put in by CA Vinit S. Mehta in preparing the publication.

I believe that this book would be immensely helpful and beneficial to the various stakeholders, members of the profession, investors and other readers in totality.

**CA. Rajkumar S. Adukia**
*Chairman,*
*Committee on Financial Markets &*
*Investors' Protection, ICAI*

# Contents

# I. HOW TO APPROACH THIS BOOK?

If you are looking at a book that will help you understand "Money" and "Ways of Dealing with it" then you can be sure of having one in your hand. Yes! More than just having a war of bombastic terminologies driving the reader crazy, this book with its subtle presentation will bind your imagination with a sense of simplicity in knowing what is to be known and understanding how to handle money.

The book does not limit itself to a mere theory on money but clearly focuses on the most interesting philosophies of investing. The book consolidates the various views expressed hitherto in a very sensible and subtle fashion making the reader feel more comfortable with the subject than ever before.

It is a compendium of money, finance, investment, asset classification and planning. The Wholesomeness of the book can be appreciated on a complete reading of the book.

The book caters to the knowledge needs of a layman to the expert views points of a professional. In short, one stop shop for one's investing knowledge, catering to the requirements of both an investor and a professional advisor.

# II. THE MONEY MANTRA

**a. What is Money?**

"Money" is a form of Exchange. One can exchange money for purchasing anything that is sold for a price. "Money" in its different forms is represented as "Income", "Expense", "Cash Flow", "Saving", "Investment", "Wealth", "Finance", "Status", and "Financial Position". Money is a powerful instrument that has a capacity to buy, earn, reap and grow. The qualities of money are similar to that of "Fire". It can both purify and make things sacred and destroy everything that comes its way.

**Why is it important to know about money?**

Knowing about money is more like knowing a person. Unless you understand the nature of the person, it becomes difficult to move with him/her. Similarly, it is very essential know the various attributes of money. Knowing these attributes will help you in taking well- informed financial decisions.

**b. Nature of Money**

**Attributes of Money**

An attribute is an inherent part of someone or something, which decides the very nature of the person or thing. In short, it is more about how a person or thing reacts or behaves given a particular circumstance.

The attributes of money can be defined as follows

a. **Motivation –** Money motivates, it has a great bearing on the emotional state of a person. Having sufficient money makes an individual self-sustained, thereby making him/her feel more secure and assured. This motivates a person to stay in the best of his temper.

b. **Attention –** If you have money, people notoce you. People notice those individuals who do well and seem more consistent.

c. **Mobility –** Money is Mobile, the nature of money is to flow. Money keeps moving from an individual to a trader, from trader to another, from a trader to a bank, from a bank to an individual.

d. **Respect –** Money needs Respect. Where money is respected, there it stays and yields more. It can well be seen, how in some households people leave money on tables and counters to be swindled away by workers, while there are others who take care to leave money in safe and appropriate places.

e. **Reservation –** Money has no reservation. Money goes to everyone. All money needs is a reason to move, it has no reservation as to the caste, creed or status of a person. It keeps changing hands.

f. **Time Value of Money -** A penny in hand today is worth more than a penny tomorrow. True to what is said, inflation plays a major role in depreciating the value of money in hand, hence holding back money in today's life is only more detrimental to its value than investing it.

g. **Growth –** Money is one non-living thing that grows. Sounds weird! Take a bank deposit or just leave it in a savings bank account, you can see money growing in its value with the interest that is paid on the bank or deposit balance. This non-living thing makes living possible for human beings.

h. **Risk –** No wonder there is a fear of losing that all powerful money. Everyone wants money, by fair or foul means, hence there is a risk of theft. You invest money for higher returns, but there is a risk of losing it as it may, in turn, be invested in highly risky ventures.

i. **Essential –** To live, to survive, to safeguard for all this and more you need money. Money defines the status of living. It is essential if you want to eat, to have a roof over your head and to safeguard your modesty. It is our life blood for good reasons. Yet money alone does not or cannot buy happiness.

**c. Truth about Money**

**Crazy Money**

- You always need more money
- You take time to make money and spend it in no time
- Money comes with risk
- Money goes to everyone
- Money can make you happy or sad
- Rich become richer and poor become poorer

**Facts about Money**

- Save money, gain more
- Never put a ceiling on your income
- Idle money is foolishness
- Money and Attention go together
- Money alone cannot give you happiness
- Good money is clean money
- Bad money is money earned through wrong means
- Man should control money otherwise it will control him
- Spending money is tricky
- Your money decides your mood
- Attention and Risk are siblings of Money

# III. THE INDIVIDUAL – THE INVESTOR

**a. The Individual and his money**

Every individual earns money to support his daily requirements in the first place, followed by other commitments. Therefore money is an essential part of his/her daily requirement. While the money earned is used for their requirements in the first place, a part of it is either set apart or the money remaining is saved for future use.

An individual becomes an investor when he actually puts his reserve money into an income earning vehicle (investment). Therefore how much money an individual saves and invests depends on his earning capacity, family requirements, spending pattern and need for future money.

**b. The Investor**

An investor is a person or entity who puts money in physical or financial assets with the objective of receiving a financial return. The investment assets include stocks, bonds, real estate, commodities, and collectibles (e.g. art). An investment portfolio involves a variety of assets that balance the rewards and risks of each investment on the whole. An investor and a speculator are two different terminologies. While a speculator makes quick and large gains from price increases, an investor waits for his asset to mature over time. The gestation period after which an investor earns his returns is generally much longer than a speculator's. The nature of return an investor can get include cash receipts, capital appreciation of the asset price. An investor's age becomes an important criterion in determining the method of investment and the strategy that is adopted in making an investment. For example a young investor tends to buy assets with price appreciation potential as there are years before he would require funds for his retirement, while an older, retired investor will require regular income and thus wants assets that offer regular cash payments.

**c. Classification of Investors**

**Investor Classification**

Investors can be classified as follows

- Salary Earners

- Self Employed/Entrepreneurs
- Professionals
- Others

They can further be categorised into

- Beginners
- Middle Level
- Final Level

**Salary Earners**

- Every month Salary is wealth accumulation
- Rule of Thumb : Always hold 3 months' salary in savings (job change/delay in payout)
- Beginners: Be more aggressive (no or less liabilities, consistent income level)
- Mid-career people – Be Moderate (more liabilities, commitments)
- High Networth Individuals (HNIs) – A balance of Moderation and Aggressiveness (More Money)

**Self Employed/Entreprenuers**

- Investment – Own Funds/Borrowed Funds
- Average of Income Earned every month
- Insurance cover for business and personal needs
- Surplus funds on savings
- Funds for further investment in business
- Loan repayment

**Professionals**

- Average earnings every month
- Loans for setting up Professional Practice and its repayment
- Monthly commitments
- Surplus savings

- Fund for further investment
- Investment in Real Estate
- Sole proprietorship/Firm/Company

**d. Age Parameters of Investors**

Investors can be classified into 3 levels based on their age parameters,

- Young
- Middle Aged
- Retired

Classification of investors based on their age becomes important as their investment decisions heavily depend on liquidity requirements and regularity of cash inflow. Also, some of the risky decisions can be taken at a younger age than at the retirement stage.

**e. Income Level of Investors**

How much you can invest depends on how much you earn and how much can be reserved or saved which can be invested. Whether the investment is going to be in thousands, lakhs or crores all depends on how much you earn. Hence income levels and expenditure pattern of the individuals greatly decide their size of investment.

# IV. THE INCOME

## a. Flow of Money

All of us procure money from various sources. Employment, self-employment, entrepreneurship, business are some of the many forms of earning money. It is widely understood that in order to have money one has to procure it (earn it).

Unfortunately, a majority of the people believe that financial planning is all about earning money. In short, what they look forward to is to know ways of earning money. Undoubtedly earning money or procuring it is the first step in financial planning but it is not all. Planning begins only after procuring it.

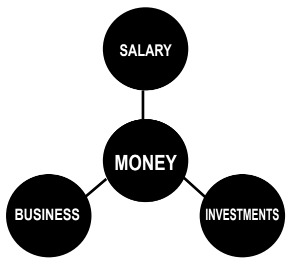
When we talk about earning money we talk about three things

1. Why should we earn money?
2. How do we earn money?
3. From where do we earn money?

**WHY?**

- To eat
- To survive
- To satisfy our daily needs
- To safeguard ourselves
- To learn
- To live
- To earn

**HOW?**



- Take up a job earn Salary
    - o Work in a company
    - o Work in a private office
    - o Work in an government organisation
    - o Work in a shop
    - o Work in an agency
    - o Work in a school
    - o Work in hospitals
    - o Work in factories
- Self Employed and earn Profit
    - o Teach
    - o Start a business
    - o Set up a shop
    - o Set up a consultancy
    - o Private practice
    - o Consider offering professional services
- Invest Money earn Returns
    - o In Business Ventures
    - o In Bank Deposits
    - o In Deposits with companies
    - o In Securities
    - o In Bonds
    - o In Loans
    - o In Government instruments
    - o In Debentures
    - o In Provident Fund
    - o In Post Office

**FROM WHERE?**

You earn money by performing an activity; the activity can be one in which you are involved personally and one in which you are not involved personally:

- Personal Involvement/Participation
- No Personal Involvement/Participation

**a. Scenario 1 - Personal Involvement/Participation – Active Money Earning**

In this scenario the money is earned by one's personal participation. Examples are

- Employment
- Proprietor Business
- Professional Practice by a Proprietor
- Vendor (Proprietor)

**b. Scenario 2 - No Personal Involvement/Participation – Passive Money Earning**

In this scenario, money is earned without one's personal participation. Examples are:

- Money invested in Business Ventures earning profit or interest
- Money with Banks earning interest
- Money in Shares earning dividend or increase in value of shares
- Money in Government securities earning fixed income
- Money in Post Office making good returns
- Money in Partnerships making profits
- Money in Joint Ventures that requires only monetary participation
- Money in Private Equity
- Money from Property (Commercial/Residential) Rentals
- Money from Bonds earning interest
- Money from IPO issues with dividends

Such earning comes handy during rainy days when one's personal participation becomes an issue due to any reason what so ever. This also helps an individual maintain his/her standard of living irrespective of the income earned by way of personal participation. It is important for everyone to make this sort of arrangement over a period of time.

Yes! Money works for you. You invest money retained with you in business ventures or investment avenues where others work to earn money for you. Therefore whether or not you participate, the money you invest is put to work and in turn fetches an income for you.

While in the first instance you work for money, in the second one, you make money work for you. In both instances, you earn additional money. Therefore procuring money as a process does not stop with just income from employment or business, it also emerges from sound investment decisions.

**TIPS on Earning Money**

1. *1. Never put a ceiling on your income*
2. *Always invest money for further earnings*
3. *Always have an alternate source of income*
4. *Earn money the right way, because, money earned out of right means is rightly spent*
5. *Tap the sources of earning money keeping your requirements in mind*
6. *It is good to save and invest money as soon as you start earning, because it is a time with less liabilities*
7. *Self-employment and Entrepreneur options can be explored even if you are in a regular employment, provided it does not affect your job or the terms of employment. Consider taking permissions if required*
8. *It is good to form a Partnership, where each of the partners is good at one aspect or the other and thereby all reap the benefits of expertise from each other*

**Caution**

1. *Never venture into a business or profession you have no idea about*
2. *It is always good to gain experience under someone before venturing out on your own*

3. *Always invest smaller amounts in business ventures before going big*

4. *Never put all the money in one basket*

**b. Nature of Income**

It is essential to know the nature of income. It is extremely important to determine its taxability, accounting, economical significance and finally the nature of use it can be put to. Income earned can be regular or seasonal. The time duration indicates the regularity of income and whether the money received is income or not.

Capital inflow of money is not taxed, whereas money earned from services rendered, performing trade, exhibition of talent, from employment is generally taxed.

**c. Regular Income and Seasonal Income**

Whether regular or Seasonal, money earned is income. This is different from gifts received, money devolving intestate, through will, lucky draw and the like. The timing of inflow of money does not alter the nature of money. Money earned is income, it can be earned by performing a service, trade, or investing money.

**d. Active and Passive Income Earning Capacity**

Money earned by one's personal participation is termed active income earning capacity and money earned without one's personal participation is termed Passive Income Earning Capacity.

**e. Levels of Income**

While so much has been discussed about money and income, it is the level of income that determines the nature of financial planning. Level of Income and Nature of Commitment are the two criteria that determine the nature and effectiveness of financial planning. A person earning ₹ 1,00,000 per month and committed to spend ₹ 85,000/month ends up saving ₹ 15,000/ month. While a person earning ₹ 60,000/month and having commitment to spend about ₹ 30,000/month saves about ₹ 30,000/month. While the standard of living and other such factors are kept outside the purview of this discussion, ultimately what matters is not what you earn, but what you keep.

# V. THE EXPENDITURE

Gone are the days when people used to have an entire cricket team tomake a family. Today's youth prefer not more than two children. With westernization coming in, the culture of joint family is changing. They prefer independence and stay away from their family. Hence people have to develop a corpus to meet their expenses and sustain without any help from family.


**Classification of Expenses –** Expenses incurred by individuals are classified based on their requirement and frequency. Thus, some of the expenditures are incurred on a monthly basis like the rent, food expense, electricity, gas, telephone, newspaper, maintenance, health, transportation, house cleaning and other miscellaneous expenses. Half yearly expenses generally include clothing, educational expenses, vehicle maintenance, insurance and renewals. Annual expenses generally consist of educational expenses, travel, insurance premium (both life and other insurance) and health expenses.

**Nature of Expenses –** While some of the expenditure incurred is fixed, is variable. Expenses like rent, insurance premium, educational expenditures are fixed at fixed time intervals, food, electricity, clothing, medical expenses are variable, depending on the season, number of people, and other requirements.

**Scale of Expenditure –** Some expenditures have a limited range of movement, certain other expenditures involve huge sums of money when incurred.  Monthly food expense, electricity, gas payment, insurance involve a certain sum of pre-determined and possibly foreseeable amounts; expenses like medical, housing equated monthly instalments, involve huge outflow of money when incurred.

**Future Plans and Contingencies –** These include expenditures planned

- Foreseen for a future event – Medical Expenses, Repayment of Loan, Purchase of Vehicle

- Earmarked Expenditures – Marriage, Higher education, Purchase of Jewellery,
- Contingencies – Emergency Health Care Expenses, Replacement of Vehicle

**Types of Expenditures**

**a.** **Monthly Maintenance –** Expenses incurred on a monthly basis by an individual, which include his basic and comfort needs. This expense is generally fixed or slightly variable in nature

**b.** **Half Yearly Maintenance –** Expenses of this nature occur on a half yearly or such similar time frames. Classic examples of such expenditure include insurance premium, instalments and educational expenses.

**c.** **Annual Maintenance –** While some expenses recur frequently, certain expenses like travel, school expenses and premium are required to be paid on an annual basis. Annual expenses generally involve large sums of money, hence planning ahead for these expenses becomes essential.

**d.** **Fixed and Variable Expenditures –** The fixed and variable nature of expenditure mainly depends on the purpose of the expenditure. Generally consumption based expenses are variable in nature. Expenses that have a price volatility impact are also variable in nature.

Nothing is constant except change. Therefore whatever is termed as fixed in nature, especially expenses like rent, premium other monthly expenses are variable over a period of time. Planning ahead for such expenses helps in handling any last minute rush

**e.** **Medical Expenses–** Classification of medical expense as a separate type of expenditure is required considering the huge amount of outflow involved. Medical and Healthcare services have improved over a period of time undoubtedly, but so have the amounts of money involved in availing of them. A doctor's consultation and purchase of medicine prescribed for general illness costs you not less than ₹ 600/-. While this is the case with a regular check-up by a doctor, treatment of specified illness, specialist consultation, surgery, other hospitalized treatments usually costs huge sums of money. Planning for such expenses becomes critical. Medical insurance is the most common method these medical expenses are generally covered with. But most of the time, the cashless compensation method offered under these insurance schemes is very difficult to obtain. So, generally the patients end up paying the amount and later on claim it from the respective insurance provider. In such circumstances, it becomes important to have sufficient money to pay for the hospital bills.

f. **Earmarked expenditures –** Earmarked expenditures include those that which are set apart for specific purposes or accumulated for expense at a future date. Marriage, higher educational expenses are some of the most common of earmarked expenditures, that generally involve an outflow of huge sums of money.

g. **Future Plans –** It is but common for individuals to have their own plan of doing things. Such plans generally include purchase of a house, jewellery, pleasure trip and pilgrimage. Expenses of such kinds require planning requires saving from an early date.

h. **Educational Expenditure -** Much similar to the medical expense are the education expenses. Right from their schooling till their graduation and post-graduation, education involves huge outflow of money. Saving for these expenditures becomes essential in order to the meet the huge admission and term fees for schools and semester fees for colleges

i. **Contingencies –** As we all know, life is full of contingencies. More than all categories of expenditures referred to in above, this one head "contingency" includes every other kind of expenditure incurred especially at a very short notice and always comes as a total surprise to the individual. Hence a sufficient sum should be set apart to meet these uninvited but essential expenditures

Classification of expenditure enables an individual to plan his needs, enables him identify his requirements, prioritise them according to importance, essentiality and time frame. This becomes one of the basic steps to determine one's financial commitment and thereby plan their finances.

# VI. THE SAVING

**What Matters?**

> ***IT IS NOT HOW MUCH MONEY YOU MAKE***
>
> ***IT IS HOW MUCH MONEY YOU KEEP***

**A quick recap**

**Why do we earn?**

We earn for our

- o needs
- o necessities
- o comforts
- o luxuries

**Is that all? Or is there something that is equally important?**

**We also very importantly earn to SAVE**

You should also earn for saving/retaining. Not all that you earn can be spent, which means you will be left with no money for emergencies.

**Borrowing** is not an option to get money; it is not procuring, *it is creating a liability to meet your need*. Such borrowed amounts are returned with interest and that is the cost you pay for borrowing money for your needs.

**What do people do with the money they earn? They**

- o pay their bills
- o expend for their monthly needs
- o pay taxes
- o repay loans and it goes on

How many people really set aside some amount for retaining? After all the expenses, they are hardly left with anything that they can retain as their savings.

As normal human beings, we earn mainly for our primary needs followed by other obligations like paying bills, taxes and the rest. Here, our primary needs include the money we would want to retain with us, our savings. Therefore while allocating the money earned, it would be wise to first allocate for our primary needs and then distribute the remaining towards our other obligations. This way, not only do you find money to save, it also keeps your expenses under check.

Well, what happens when the remaining money allocated is not sufficient to meet your obligations with the government (taxes), creditors (loan, bills)? You should pay the amounts otherwise you will be penalized and made to suffer. It means you are under pressure to find money to pay them in time. Well, this kind of pressure works well to find ways and means of earning more money than what you actually get paid. In other words you explore options of making more money.

Any legal means of making money is welcome, because good money and bad money have their respective characteristics. Therefore, what we find here is that shifting your focus to satisfy your needs first is indirectly making you explore more options of making money or procuring money.

As discussed earlier, procuring money can be active or passive. At this juncture, we should appreciate the fact that how a shift in focus actually and automatically changes our approach towards money, its procurement, retaining and investment.

All of the above and more to come, takes us through the nature of money, nature of investors and all about being wise with money.

**a. Classifying Savings**

Savings can be classified as

- o Saving to Retain
- o Saving for Future Expenses

**Saving to Retain**

This constitutes actual saving. It is the amount that accumulates into a corpus for safe keeping and for further investment. Hence one should ensure sufficient amount of money is accumulated by carefully planning your expense.

**Saving for Future Expenses**

This amounts to saving for future expenses, or, in short, earmarking money for a particular expense. This is saving for a short term. This amount is meant to be spent. Therefore, in the long term such savings cannot be counted for savings or retained earnings.

Examples of such expenses are as follows

- o Saving for Marriage expenses
- o Saving to buy Vehicles
- o Saving for Medical Expenses
- o Saving for decorating the house
- o Saving for replacements
- o Saving for vacations
- o Saving for celebrations
- o Saving for functions
- o Saving for Gifting
- o Saving for Household maintenance and repair
- o Saving for Children's Educational expenses – yearly school fees, college fees, Coaching classes, exam fees
- o Saving for Higher Education
- o Saving for Household items (as their value depreciates over a period of use)

Classifying people into rich and poor only signifies their financial acumen towards being good and bad investors. Good investors do not just work hard to earn money, but also make money work for them. It helps them maintain not just their financial stability but also supports them during a rainy day. On the other hand, bad investors stick to certain self-made and widely believed rules that only hard work can earn them good money and completely neglect the aspect of investing and the concept of passive money.

Now, it is clear how the rich get richer and the poor get poorer. Being wise with money and financial decisions has nothing to do with greed. The only difference is, greed is about getting rich overnight and being financial wise is growing rich by the day.

**TIPS on Saving Money**

1. *Squeeze expenses and Save, it pays.*
2. *Cut wasteful expenditure from your Budget*

3. *Cut down on Luxury*
4. *Small is Beautiful, keep things small they help in keeping expenses under check*
5. *Save in the name of Minor Children*
6. *Differentiate between what you deserve and what you desire*
7. *Save Surplus Fund whether out of monthly income or any windfall*
8. *Aim at accumulating corpus out of money saved*
9. *It is good to set aside your savings before you start spending for the month*
10. *Aim at saving a certain amount every month and follow religiously*

**Caution**

1. *Saving should be kept safe*
2. *Do not invest all your savings, keep a safe amount in bank accounts or fixed deposits for emergencies*
3. *Do not go by your friend's experience in Investment, always enquire and research on your own as well*

# VII. THE ART OF FINANCIAL PLANNING

**a. Why Financial Planning?**

**What is Financial Planning?**

It is a process that uses your financial resource to satisfy your financial goals. In short, it helps you plan the use of your money to meet your needs and retain something for rainy days.

**Who needs financial planning?**

There is no rule of thumb as to who is classified to plan their finances. It applies to everyone who uses money to survive in this world, the difference lies only in their scale and level of income, investments and expenses.

**Does every one plan their finances?**

Not really, because they hardly know what it means to plan their finance and hence always have reasons to postpone it. And people who have done it have not just been fair with their money, but have also generated wealth for themselves and their generations.

**b. How does Financial Planning help?**

**a. Steps in Financial Planning**

While Financial Planning is a process of planning your finances, there are certain things you need to know before you could proceed with the planning phase. The factors to consider before financial planning can be described in 4 steps below. A fair understanding of these four steps is sure to make the financial planning process more meaningful

- Step 1 • Know Your Financial Goals
- Step 2 • Know Your Financial Position
- Step 3 • Know Your Rists
- Step 4 • Know Your Investments

- **Knowing Your Financial Goals**

  Financial goals of an individual define what he or she would like to achieve in terms of money over a period of time. Some examples of financial goals are

  - Buying a residential property worth 3 crore in April 2013
  - Saving ₹ 60 lakhs for daughter's marriage expenses in 2030
  - Purchasing a resort worth ₹ 1 crore in Kerala
  - Planning for a retirement income of ₹ 6 lakh per month starting 2030
  - Repaying Housing loan worth ₹ 35 lakh in 5 years starting from 2014
  - Purchasing Gold worth 5 lakh in 3 years' time
  - Saving ₹ 10 lakh for renovating the independent house in Delhi in 2 year's time

  These goals can be divided into Short Term, Medium Term and Long Term depending upon the means available to support them.

- **Knowing Your Financial Position**

  **Cash Flow Statement**

  A statement that gives details about how much money you received, how much you spend and how much you save is called the cash flow statement.

  A cash flow statement consists of details pertaining to cash received and cash paid during the years irrespective of the year to which it belongs. All payments made by way of cash or through bank are considered and payments made from all bank accounts are considered. The payments could be for expenses, repayment, investment and loan-everything is considered. The balancing figure is generally allocated among bank balances and cash in hand.

  This statement is a basic document to be prepared in case of individuals who do not maintain proper books of account. From the details available in this account a Statement on Income and Expenditure and Balance Sheet can be prepared.

**Statement on Networth**

A Statement on Networth provides a quick look at your financial situation at a certain point of time. It gives details about your assets, liabilities, and the difference between the two is your networth. In short, it tells you how much money you will be left with had you paid of all your liabilities with the help of money from your assets ( cash generated by way of interest or by sale of the asset).

**Sample Networth Statement**

| | Mr. Vijay Kulkarni |
|---|---|
| **Liquid Assets** | ₹ |
| Savings Account | 5,00,000 |
| Fixed Deposit with Bank | 3,00,000 |
| Liquid Fund | - |
| Cash | 50,000 |
| **Invested Assets** | |
| Stocks | 1,00,000 |
| Mutual Funds | 2,00,000 |
| Bonds | 1,00,000 |
| PPF | 5,00,000 |
| Gold | 3,00,000 |
| Real Estate – Land | 25,00,000 |
| **Other Assets** | |
| House | 50,00,000 |
| Car | 5,50,000 |
| **Total Assets (A)** | **98,00,000** |
| **Liabilities** | |
| Home Loan | 40,00,000 |
| Car Loan | 2,00,000 |
| **Total Liabilities (B)** | **42,00,000** |
| **Total Networth (A-B)** | **56,00,000** |

**Investment Calculations**

Investment calculations involve preparing a schedule for saving target one wishes to reach keeping their long term goals in mind. While preparing these figures one has to have in mind the Time value of money concept, for we all know that a rupee earned today is far more valuable than a rupee earned tomorrow. Also it will be of interest to reader to know the magic Compounding Interest can create.

**Compounding Effect**

People with very limited income have been able to save around ₹ 3 to 4 crores by investing in equities over a period of two to three decades amounts in the range of ₹ 10, 50 and 500.

The idea behind preparing a cash flow statement or a Networth statement is for the investor or the individual to understand his position and what exactly he does with money he earns or receives. Where an individual has savings in lakhs of rupees earning an interest of about 6%, it will be worthwhile to pay off his loans taken at the rate of 16% from the savings held, instead of retaining the savings and repaying the loan with interest.

- **Knowing Your Risk**

  Every individual born in this world has some kind of risk to face. While some of them are not manmade choices, the others are. On this basis we can divide the risk into General Risk and Risk of Choice

  - **General Risk –** General risk includes loss of life, loss of property, disability, risk of health and few other uncalled for liabilities
  - **Risk of Choice –** This risk is concerned with the choice we make as far as our investments are concerned, in other words we can also call it a Financial Risk. There can be a loss or a gain. In case of business ventures, and professional practice, the environment can be favourable or adverse. It also includes the risk of investing in equities, gold and real estate
  - **Know Your Investments**

    Now, having had a fairly good idea about your goals, your financial position and the possible risks you are about face, it's time to evaluate how to put the money you have saved into use and also to decide what percentage of money saved will be invested to meet your Short term, Medium term and Long term goals.

**c. When should one opt for Financial Planning?**

The moment one begins earning money or has property to manage, one should opt for Financial Planning.

**How does financial planning work for you?**

You are the focus of the Financial Planning process. As such, the results you get from working with a Financial Planner are as much your responsibility as they are those of the Planner. To achieve the best results from your Financial Planning engagement, you will need to be prepared to avoid some of the common mistakes shown above by considering the following advice:

- **Set measurable goals**

  Set specific targets of what you want to achieve and when you want to achieve results. For example, instead of saying you want to be 'comfortable' when you retire or that you want your children to attend 'good' schools, you need to quantify what 'comfortable' and 'good' mean so that you'll know when you've reached your goals.

- **Understand the effect of each financial decision**

  Each financial decision you make can affect several other areas of your life. For example, an investment decision may have tax consequences that are harmful to your estate plans. Or a decision about your child's education may affect when and how you meet your retirement goals. Remember that all of your financial decisions are interrelated.

- **Re-evaluate your financial situation periodically**

  Financial Planning is a dynamic process. Your financial goals may change over the years due to changes in your lifestyle or circumstances, such as an inheritance, marriage, birth, house purchase or change of job status. Revisit and revise your Financial Plan as time goes by to reflect these changes so that you stay on track with your long-term goals.

- **Start planning as soon as you can**

  Don't delay your Financial Planning. People, who save or invest small amounts of money early, and often, tend to do better than those who wait until later in life. Similarly, by developing good Financial Planning habits such as saving, budgeting, investing and regularly reviewing your finances early in life, you will be better prepared to meet life changes and handle emergencies.

- **Be realistic in your expectations**

  Financial Planning is a common sense disciplined approach to managing your finances to reach life goals. It cannot change your situation overnight; it is a lifelong process. Remember that events beyond your control such as inflation or changes in the stock market or interest rates will affect your Financial Planning results.

- **Realise that you are in charge**

  If you're working with a Financial Planner, be sure you understand the Financial Planning process and what the Planner should be doing. Provide the Planner with all of the relevant information about financial status. Ask questions about the recommendations offered to you and play an active role in decision-making.

**Planning your Finances**

- Financial Planning is a must
- Know where you stand – Net Worth (Assets – Liabilities), Personal Budget
- Make your financial goals clear – Goals and Objectives - Major Purchase, Children's Education, Retirement, Marriage, Vacation
- Know how to reach your targets and time lines
- Implement your financial plan
- Reap the benefits

**d. What is the Role of a Professional Financial Planner?**

The role of a Professional Financial Planner is that of a trusted professional who offers advice that best suits your financial status and financial needs. Well, in order to ensure that such professionals are carefully chosen and well regulated, investment advisors or professional financial planners are regulated with the help of The (Investment Advisors) Regulation 2013

## PORTFOLIO MANAGERS/WEALTH MANAGERS/INVESTMENT ADVISORS (IA) REGULATION

### Who can become Portfolio Managers?

- Chartered Accountants
- Certified Financial Planners
- Chartered Financial Analysts
- Management Graduates with specialisation in Finance

### Investment Advisors Regulation in India

- On January 21, 2013 SEBI issued The (Investment Advisors) Regulation 2013
- These regulations shall come into force on the 90th day from the date of notification i.e., April 20, 2013
- Regulating the activity of Investment Advice
- Investment Advice – Advice on Investment Products and Financial Planning
- Regulation exempts number of intermediaries and intermediation activities from Registration
- Consultation on hedging and cash management services likely to be covered

### Investment Advisors Registration

- Registration with SEBI as Investment Advisor (IA)
- Subject to fulfilment of certain basic criteria
  - Minimum educational qualification
  - Affiliation with National Institute of Securities Market

### Regulation of Investment Advisors

- Regulation imposes responsibility on IAs
  - Fiduciary responsibility towards client

  - Record keeping
  - Suitability Appropriateness
  - Code of Conduct
  - Disclosures of conflict of interests
  - Segregation of Activities other than investment advisory
  - Payment of Commission
- Stock Brokers and Merchant bankers (exempted from IA registration)
  - Are required to comply with provisions relating to
    - Manner in which clients are to be boarded
    - Investment advice is to be rendered

**Exemptions**

- Any member of
  - ICAI, ICSI, ICWAI
  - Actuarial Society of India or
  - any other professional body as may be specified by the Board, who provides investment advice to their clients, incidental to his professional service.
- Any stock broker or sub-broker registered under SEBI (Stock Broker and Sub-Broker) Regulations, 1992
- Portfolio manager registered under SEBI (Portfolio Managers) Regulations, 1993 or
- Merchant banker registered under SEBI (Merchant Bankers) Regulations, 1992, who provides any investment advice to its clients incidental to their primary activity
- Any fund manager, by whatever name called of a mutual fund, alternative investment fund or any other intermediary or entity registered with the Board
- Any person who provides investment advice exclusively to clients based out of India. Any representative and partner of an investment adviser which is registered under these regulations
- Any other person as may be specified by the Board

**Registration Fees**

- Every applicant shall pay non-refundable application fees of five thousand rupees (₹ 5,000) along with the application for grant or renewal of certificate of registration.
- Applicants who are individuals and firms shall pay a sum of ten thousand rupees (₹ 10,000) as registration/ renewal fee at the time of grant or renewal of certificate by the Board.
- A body corporate shall pay a sum of one lakh rupees (₹ 1,00,000) as registration/ renewal feeat the time of grant or renewal of certificate by the Board.
- The above fees shall be paid by the applicant within fifteen days (15 days) from the date of receipt of intimation from the Board by a demand draft (DD) in favour of 'Securities and Exchange Board of India' payable at Mumbai or at respective regional or local office.

**Registration Procedure**

- The Applicant for grant of registration as an Investment Adviser under SEBI (Investment Advisers) Regulations, 2013 should make an application to SEBI in Form A
- The applicant will receive a reply from SEBI within one month.

**Capital Requirement**

- *Case of Body Corporates:* Net worth of not less than twenty five lakh rupees (₹ 25,00,000)
  - "Net Worth" means the aggregate value of paid up share capital plus free reserves (excluding reserves created out of revaluation) reduced by the aggregate value of accumulated losses, deferred expenditure not written off, including miscellaneous expenses not written off, and capital adequacy requirement for other services offered by the advisers in accordance with the applicable rules and regulations.
- *In Case of Individuals / Partnership firms:* Net tangible assets of value not less than one lakh rupees (₹ 1,00,000)

**Status of Existing Investment Advisers**

- Existing investment advisers shall comply with the capital adequacy requirement within one year from the date of commencement of these regulations.

**Period of Validity**

- *Period of Validity* of the Certificate is five years (5 years) from the date of issue.
- *Renewal of Certificate:* Three months before the expiry of the period of validity of the certificate, the Investment adviser may, if he so desires, make an application in FORM-A for grant of renewal of certificate of registration. The renewal application also dealt in the same manner as if investment adviser is applying for the first time.

**e. Why Financial Planning is called an 'Art'?**

Financial planning requires what is called an aptitude towards segregating available resources among various avenues of money making and also safely setting apart a chunk of it for immediate and definite use. It requires a precise understanding of one's status, needs, requirements and available source of money and accordingly making available the resource where and when it is required.

**f. Benefits of Financial Planning**

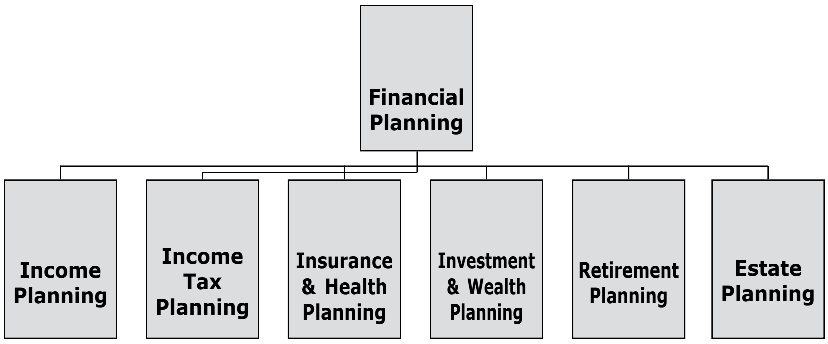
Financial Planning provides direction and meaning to your financial decisions. It allows you to understand how each financial decision you make affects other areas of your finances. For example, buying a particular investment product might help you pay off your mortgage faster or it might delay your retirement significantly. By viewing each financial decision as part of the whole, you can consider its short and long-term effects on your life goals. You can also adapt more easily to life changes and feel more secure that your goals are on track.

Proper financial planning tends to make life more systematic and earning more consistent. By now you identify the sources of income, the quantum of income from each of the different sources, estimate the expenditure both short term and long term, plan for expenses, invest savings in different types of investments, above all you are rest assured that the path which you have chosen is wise.

This is indeed the ultimate benefit of planning your finances. You are assured peace of mind, and financial soundness definitely increases the scope and growth of one's wealth. At the end of the day what do you live for, it is for a peaceful night's sleep preparing for an enthusiastic tomorrow.

**g. Components/Elements of Financial Planning**

**Categorisation of Financial Planning**




**Income Planning**

An individual's income planning strategy defines his sources of income and how he plans to meet his short and long term goals.

**Sources of Income**

- o Salary
- o Business Income
- o Self-Employment
- o Investment Income

While the first three sources of income invariably require personal participation by the individual, investment income does not require his personal participation but still generates income. Therefore, while dealing with the sources of income it is important to have both active and passive income sources that help the individual in those days when personal participation becomes difficult.

**Income Tax Planning**

People falling in the high income category end up paying close to 30% of their earnings in the form of taxes. Hence investments offering tax benefits should be the preferred option. Knowledge on simple tax saving investments can help in planning for their taxes.

**Chapter VIA—Deductions under the Income Tax Act, 1961**

| S.No | Section | Quick Description | Limit |
|---|---|---|---|
| 1 | 80 CCC | Pension Products | Maximum ₹ 1 lakh deduction for 80 C, CCC and 80 CCD put together |
| 2 | 80 CCD | C. Govt Employees Pension scheme | Maximum ₹ 1 lakh deduction for 80 C, CCC and 80 CCD put together |
| 3 | 80 D | Premium Paid on Medical Insurance for Family and Parents | Deduction between ₹ 15,000-20,000, additional deduction of 15,000 for parents and ₹ 20,000 if they are senior citizens |
| 4 | 80 DD | Maintenance and medical treatment of disabled dependent | Deduction up to ₹ 1 lakh |
| 5 | 80 DDB | Treatment of Certain diseases or ailment | Deduction up to ₹ 60,000 |
| 6 | 80 U | Physically Disabled Assessee | Deduction up to ₹ 1 lakh |
| 7 | 80 G | Donation to certain charitable fund, institutions etc | 50% to 100% of donation made subject to a max of 10% of gross annual income |
| 8 | 80 GGA | Donations for scientific research or rural development | 100% deduction allowed to donations made to scientific research Sec. 80 GGC |
| 9 | 80 GGC | Donation to Political Parties | Deduction up to ₹ 60,000 |
| 10 | 80 E | Interest Payable on Educational loan | No limit for deduction |
| 11 | 80 EE | Interest payable on housing loan | Additional deduction up to ₹ 1 lakh |

| S.No | Section | Quick Description | Limit |
|---|---|---|---|
| 12 | 80 GG | For paying rent in case of no HRA | Deduction up to ₹ 24,000 |
| 13 | 80 CCG | RGESS | Deduction up to ₹ 25,000 (50% of amount invested) |
| 14 | 80 TTA | Interest received in Saving Bank Account | Deduction up to ₹ 10,000 |

**Insurance and Health Planning**

"Security is something we all look for...

(a) Security of Our Future,

(b) Security of Finances,

(c) Security of Our Loved Ones.

This makes Insurance Planning important"goes a popular saying that explains the importance of Insurance Planning.

It is extremely important that every person, especially the breadwinner, covers the risks to their life, so that their family's quality of life does not undergo any drastic change in case of an unfortunate eventuality.

So what are the risks that we run? To name a few—

- Risk on our lives - the worries of replacement of the income that we contribute to the running of the household
- Risk of medical contingencies - since they have the capability of depleting our wealth considerably
- Risk to assets - as the replacement of these can have tremendous financial implications

  If we can imagine a situation where our goals are disturbed by acts beyond our control, we realize the relevance of insurance in our lives. Insurance, simply put, is the cover for all the risks that we run into during our lives. Insurance enables us to live our lives to the fullest, without worrying about the financial impact of events that could hamper it. In other words, insurance protects us from the contingencies that could affect us.

## 1. Why Insurance Planning?

Insurance Planning is concerned with ensuring adequate coverage against insurable risks. Calculating the right level of risk cover is a specialised activity, requiring considerable expertise. Proper Insurance Planning can help you look at the possibility of getting a wider coverage for the same amount of premium or the same level of coverage for the same amount of premium or the same level of coverage for a reduced premium. Hence, the need for proper insurance planning.

Insurance Planning takes into account the risks that surround you and then provides an adequate coverage against those risks. There is no risk not worth insuring yourself against. Be it life or non-life. And insurance should first and foremost be looked as a measure to guard against all risks. Now depending upon person to person Insurance needs differ too. It depends on your age, profile, requirements, level of risks, your income etc. So insurance planning takes into account all the factors before chalking out a plan customised for you and gives you the most suitable option.

## 2. Life Insurance Planning

### *(1) What is Life Insurance?*

Life Insurance is a contract for payment of a sum of money to the person assured (or failing him/her, to the person entitled to receive the same) on the happening of the event insured against. Usually the contract provides for the payment of an amount on the date of maturity or at specified dates at periodic intervals or at unfortunate death, if it occurs earlier. Among other things, the contract also provides for the payment of premium periodically to the Corporation by the assured. Life insurance is universally acknowledged to be an institution which eliminates 'risk', substituting certainty for uncertainty and comes to the timely aid of the family in the unfortunate event of death of the breadwinner. By and large, life insurance is civilization's partial solution to the problems caused by death. Life insurance, in short, is concerned with two hazards that stand across the life-path of every person: that of dying prematurely leaving a dependent family to fend for itself and that of living to old age without visible means of support.

### *(2) Your Life Insurance Needs*

Calculating life insurance needs is not a simple exercise but you must evaluate your current and required cover in 2012 and take corrective action. Remember that each of us has our own lifestyle, goals, aspirations and dependents which may be completely different from the life situation for your friend or colleague. So what works for someone else may not work for you.

There are essentially three ways to calculate your insurance needs

**(a)** ***Expense protection:*** Calculates the corpus required to take care of the family's future expenses and goals. Inflation diminishes the value of money and hence expenses need to be adjusted to inflation for calculation of protection required.

**(b)** ***Human life value:*** It is the economic value of an individual; the present value of all his or her future income. Setting aside a part of income one spends on oneself, the protection required through human life value calculates today's value of one's income for the years till his or her retirement.

**(c)** ***Needs analysis:*** In this method you calculate your needs by considering each of your dependents and what financial milestones you want to achieve for them. The needs may range from child education, marriage to repayment of loans. Next you assess your current assets and investments and shortfall due to loss of life. This gap in income can be filled up by insurance.

***(3) For what term do you need this cover?***

Ideally, insurance must be taken to cover the working period in one's life. You take insurance to protect your dependents from the loss of your income; using the same logic, you take insurance for the time that the dependents are being supported by your income. Hence, it is advisable to take insurance till one's retirement. However, when insurance is taken for protecting and saving towards specific goals, then the tenure of the plan should match the years left for meeting the goal.

***(4) What type of products suit you?***

Choosing a product will depend on the specific need and the life stage one is in. What is the final product you will choose? When there are multiple choices that match the need, it is the affordability that makes the final choice. Most importantly, individuals must be aware of the purpose of the insurance they are buying. They must know that life insurance products for investment and savings are structured for the long term and meant for someone who is earning and whose earnings are supporting his/her dependent(s).

### *(5) Financial planning and its role in selecting insurance*

To be able to prescribe the best insurance products for an individual or family, a financial plan is necessary. Any adviser needs an indepth knowledge and understanding and proper prioritisation of all aspects of your life. The probable duration of life, amount of security needed, present and future needs/ shortfalls and post retirement requirements are also essential pieces of information to be collected. Knowledge of the "markets"/mutual funds and economic climate coupled with comprehension and application of HLV (human life value), expense protection, and corpus requirements for retirement help in prescribing an effective solution.

With the awareness of a need for proper financial planning on the rise, coupled with the plethora of insurance products available, it is imperative that you take a decision only after doing your home work or engaging a competent financial planner.

*In a nutshell:*

- Insurance Planning is the first step to cover against risk.
- Opting for adequate life insurance cover is essential. It is very important that you are adequately covered as inadequate cover is equal to no cover at all.
- Insurance requirement to be reviewed once in every 2 years
- Insurance secures our
  - Future
  - Finances
  - Loved Ones
- Insurance planning is the first step towards financial planning and financial planning should be the first step towards purchasing insurance. To advise an individual on his or her insurance needs, it is important to get a holistic view of the present and the future.

- Insurance requirement must be reviewed every two years or when there is a change in the family scenario, for example: the addition of dependents.
- The insurance requirement changes with every change in your life – income, expenses, life style, members, liabilities and assets.

**Types of Life Insurance Policies**

Taking out a life insurance policy covers the risk of dying early, by providing for your family in the event of your death. It also manages the risk of retirement – providing an income for you in non-earning years. Choosing the right policy type with the coverage that is right for you therefore becomes critical.

There are a variety of policies available in the market, ranging from Term Endowment and Whole Life Insurance, to Money Back Policies, ULIPs, and Pension plans. Let's see what each of these is about, so that you can consider the one that best suits you.

***(1) Term insurance policy***

A term insurance policy is a pure risk cover for a specified period of time. This means that the sum assured is payable only if the policyholder dies within the policy term. For instance, if a person buys ₹ 2 lakh policy for 15-years, his family is entitled to the money if he dies within that 15-year period.

If he survives the 15-year period he is not entitled to any payment; the insurance company keeps the entire premium paid during the 15-year period.

So, there is no element of savings or investment in such a policy. It is a 100 per cent risk cover. It simply means that a person pays a certain premium to protect his family against his sudden death. He forfeits the amount if he outlives the period of the policy. This explains why the Term Insurance Policy comes at the lowest cost.

*This is suitable for you if…*

You are looking for a low cost life cover without any savings benefits attached.

Or

You are at that stage in life where insurance cover is vital but you cannot afford high premium payment due to low income.

### (2) *Whole Life Policy*

As the name suggests, a Whole Life Policy is an insurance cover against death, irrespective of when it happens.

Under this plan, the policyholder pays regular premiums until his death, following which the money is handed over to his family.

This policy, however, fails to address the additional needs of the insured during his post-retirement years It doesn't take into account a person's increasing needs either. While the insured buys the policy at a young age, his requirements increase over time. By the time he dies, the value of the sum assured is too low to meet his family's needs.

As a result of these drawbacks, insurance firms now offer either a modified Whole Life Policy or combine it with another type of policy.

### (3) *Endowment Policy*

Combining risk cover with financial savings, endowment policies are the most popular policies in the world of life insurance. In an Endowment Policy, the sum assured is payable even if the insured survives the policy term.

If the insured dies during the tenure of the policy, the insurance firm has to pay the sum assured just as any other pure risk cover.

A pure endowment policy is also a form of financial saving, whereby if the person covered remains alive beyond the tenure of the policy, he gets back the sum assured with some other investment benefits.

In addition to the basic policy, insurers offer various benefits such as double endowment and marriage/education endowment plans. The cost of such a policy is slightly higher but worth its value.

*This is suitable for you if…*

You want to accumulate capital for anticipated financial needs like buying an asset such as a home, providing for your old age, your children's education, marriage, etc.

### (4) *Money Back Policy*

These policies are structured to provide sums required as anticipated expenses (marriage, education, etc) over a stipulated period of time. With inflation becoming a big issue, companies have realized that sometimes the Money value of the policy is eroded. That is why with-profit policies are also being introduced to offset some of the losses incurred on account of inflation. A portion of the sum assured is payable at regular intervals. On survival, the remainder of the sum assured is payable.

In case of death, the full sum assured is payable to the insured.

The premium is payable for a particular period of time.

*This is suitable for you if...*

You plan to utilize the funds received from the policy for your future anticipated needs like a car, an overseas holiday, children's educational needs, marriage expenses, etc.

***(5) Annuities and Pension***

In an annuity, the insurer agrees to pay the insured a stipulated sum of money periodically. The purpose of an annuity is to protect against risk as well as provide money in the form of pension at regular intervals.

***(6) Unit linked Insurance Plan (ULIP)***

It has the features of both the life cover and investments. The sum assured here is limited i.e., cover is provided to the extent of 50% after six months of the policy term. The insured is given a choice to select the investment plan he wants his money to be invested in. Therefore he has control over his investment & he can periodically supervise his investment. The insurer invests approximately 80% in Investment plans and the balance 20% in risk cover and other expenses. The insured is then allotted units for his investment on the basis of prevailing NAV of the plan.

***(7) Riders: Comprehensive coverage***

In addition to the insurance plan of your choice, you might want to consider additional risk covers, in which case you can you can opt for riders: additional benefits that can be purchased with an insurance policy. Examples of riders include the Term rider, the Accidental Death Benefit rider, and the Critical Illness rider. Choosing the right set of riders ensures a comprehensive insurance cover.

When considering a life insurance policy with riders, make sure to understand the exclusions in the policy. For example, under Term Insurance, if the insured person commits suicide, whether sane or insane, within one year from the date of commencement of a term policy, the cover will become void, i.e. the nominee cannot claim the sum assured. Only the premiums paid up to the date of death will be refunded after deducting the expenses incurred by the insurer for issuing the cover.

As important as it is to buy Life Insurance, it is even more important to pay your premiums on time. A life insurance company provides the insured with a grace period of 30 days i.e. a period of 30 days after the start date of the policy. The insured can pay premium on any day during this grace period. In case the insured dies during the grace period, the insurer is liable to pay the death benefit to the nominee less any amount outstanding (including the unpaid premium). This provision helps the insurer to minimize the risk of policy lapse unintentionally.

In these uncertain times, you're better off planning ahead, and securing the future for yourself, and your family. Arm yourself with the facts for an assurance of a lifetime of security.

### *5. Tax Benefits through Insurance*

Every financial planning culminates in March— the last month of a financial year. People are looking forward to get tax benefits through buying insurance. You can avail both (a) deductions from taxable income and (b) exemption of proceeds from tax.

Tax Benefits can be availed through both life insurance and health insurance. Whenever we talk about tax benefits, we come across the following sections of the Income Tax Act 1961 time and again. Let's discuss them further:

**Section 80C** - Deduction in respect of life insurance premia, deferred annuity, contributions to provident fund, subscription to certain equity shares or debentures, etc.

In computing the total income of an assessee, being an individual or a Hindu undivided family, there shall be deducted, in accordance with and subject to the provisions of this section, the whole of the amount paid or deposited in the previous year, being the aggregate of the sums referred to as does not exceed one lakh rupees. This section lets you avail tax benefits to maximum amount of ₹ 1 lakh.

The sums referred to includes any sums paid or deposited in the previous year by the assessee —

(*i*) to effect or to keep in force an insurance on the life of persons specified

(*ii*) to effect or to keep in force a contract for a deferred annuity, not being an annuity plan referred to in clause (xii), on the life of persons specified in sub-section (4)

**Provided** that such contract does not contain a provision for the exercise by the insured of an option to receive a cash payment in lieu of the payment of the annuity;

The provisions shall apply only to so much of any premium or other payment made on an *insurance policy, other than a contract for a deferred annuity, issued on or before the 31st day of March, 2012*, as is not in excess of twenty per cent of the actual capital sum assured.

*Explanation.*— In calculating any such actual capital sum assured, no account shall be taken—

(*i*) Of the value of any premiums agreed to be returned, or

(*ii*) Of any benefit by way of bonus or otherwise over and above the sum actually assured, which is to be or may be received under the policy by any person.

The provisions shall apply only to so much of any premium or other payment made on an insurance policy, other than a contract for a deferred annuity, issued on or after the 1st day of April, 2012 as is not in excess of ten per cent of the actual capital sum assured.

**Provided** that where the policy, issued on or after the 1st day of April, 2013, is for insurance on life of any person, who is —

(a) a person with disability or a person with severe disability as referred to in section 80 U, or

(b) suffering from disease or ailment as specified in the rules made under section 80 DDB,

the provisions of this sub-section shall have effect as if for the words "ten per cent", the words "fifteen per cent" had been substituted.

*Explanation.*— For the purpose of this sub-section, "actual capital sum assured" in relation to a life insurance policy shall mean the minimum amount assured under the policy on happening of the insured event at any time during the term of the policy, not taking into account—

(i) The value of any premium agreed to be returned; or

(ii) Any benefit by way of bonus or otherwise over and above the sum actually assured, which is to be or may be received under the policy by any person.

***Section 80D -* Deduction in respect of health insurance premia**

In computing the total income of an assessee, being an individual or a Hindu undivided family, there shall be deducted such sum, as specified payment of which is made by any mode as specified in the previous year out of his income chargeable to tax.

The sum referred to above shall be the aggregate of the following, namely:

(a) The whole of the amount paid to effect or to keep in force an insurance on the health of the assessee or his family or any contribution made to the Central Government Health Scheme or such other scheme as may be notified by the Central Government in this behal for any payment made on account of preventive health check-up of the assessee or his family as does not exceed in the aggregate ₹ 15,000/-; and

(b) The whole of the amount paid to effect or to keep in force an insurance on the health of the parent or parents of the assessee or any payment made on account of preventive health check-up of the parent or parents of the assesse as does not exceed in the aggregate ₹ 15,000/-.

Here "family" means the spouse and dependent children of the assessee.

Where the amounts referred to above are paid on account of preventive health check-up, the deduction for such amounts shall be allowed to the extent it does not exceed in the aggregate ₹ 5,000/-.

Mode of Payment for preventive health check-up shall be made by—

(i) Any mode, including cash, in respect of any sum paid on account of preventive health check-up;

(ii) Any mode other than cash in all other cases

Where the assessee is a HUF, the sum referred above shall be the whole of the amount paid to effect or to keep in force, an insurance on the health of any member of that HUF as does not exceed in the aggregate ₹ 15,000.

Where the sum specified above is paid to effect or keep in force an insurance on the health of any person specified therein, and who is a senior citizen, the sum shall not exceed ₹ 20,000/-.

"Senior citizen" means an individual resident in India who is of the age of *sixty years* or more at any time during the relevant previous year.

The insurance referred shall be in accordance with a scheme made in this behalf by—

(a) The General Insurance Corporation of India formed under section 9 of the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972) and approved by the Central Government in this behalf; or

(b) Any other insurer and approved by the Insurance Regulatory and Development Authority established under sub-section (1) of section 3 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999).

***Section 10(10D) - Incomes not included in total income***

In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included, any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy, other than —

(a) Any sum received under sub-section (3) of section 80DD or sub-section (3) of section 80 DDA; or

(b) Any sum received under a Keyman insurance policy; or

(c) Any sum received under an insurance policy issued on or after the 1st day of April, 2003 but on or before the 31st day of March, 2012 in respect of which the premium payable for any of the years during the term of the policy exceeds 20% of the actual capital sum assured; or

(d) Any sum received under an insurance policy issued on or after the 1st day of April, 2012 in respect of which the premium payable for any of the years during the term of the policy exceeds 10% of the actual capital sum assured

Provided that the provisions of sub-clauses (c) and (d) shall not apply to any sum received on the death of a person:

Provided further that for the purpose of calculating the actual capital sum assured under sub-clause (c), effect shall be given to the Explanation to sub-section (3) of section 80C or the Explanation to sub-section (2A) of section 88, as the case may be.

**The following third proviso shall be inserted after the second proviso to sub-clause *(d)* of clause *(10D)* of section 10 by the Finance Act, 2013, w.e.f. 1-4-2014**

Provided also that where the policy, issued on or after the 1st day of April, 2013, is for insurance on life of any person, who is —

(i) a person with disability or a person with severe disability as referred to in section 80 U; or

(ii) suffering from disease or ailment as specified in the rules made under section 80 DDB, the provisions shall have effect replacing "10%", to "15%".

For the purposes of this clause, "Keyman insurance policy" means a life insurance policy taken by a person on the life of another person who is or was the employee of the first-mentioned person or is or was connected in any manner whatsoever with the business of the first-mentioned person and includes such policy which has been assigned to a person, at any time during the term of the policy, with or without any consideration.

**Investment and Wealth Planning**

Investment planning/management, also known as portfolio management, is not a simple activity as it involves many complex steps as explained below:

***(1) Investment objectives & constraints***

The main objectives to be taken into consideration by investors are capital appreciation, current income and safety of principal. The relative importance of each of these objectives needs to be determined. The main aspect that affects the objectives is risk. Some investors are risk- takers while others try to reduce risk to the minimum level possible. Identification of constraints arising out of liquidity, time horizon, tax and special situations needs to be addressed.

***(2) The Asset Mix***

The right asset mix is an important consideration affects in deciding on the proportion of equity shares or shares of equity- oriented mutual funds i.e. stocks and proportion of bonds in the portfolio. The combination of the number of stocks and bonds depends upon the risk tolerance of the investor. This step also involves deciding on the classes of asset investments s and also determines which securities should be purchased in a particular class.

***(3) The Portfolio Strategy***

There are two types of portfolio strategies. The first is an active portfolio strategy which aims to earn greater risk adjusted returns depending on the market timing, sector rotation, security selection or a mix of these. The second strategy is the passive strategy which involves holding a well- diversified portfolio and also maintaining a pre-decided level risk.

***(4) Securities***

Investors usually select stocks after a careful fundamental and technical analysis of the security they are interested in purchasing. In case of bonds credit ratings, liquidity, tax shelter, term of maturity and yield to maturity are factors that are considered.

***(5) Implementing Portfolio***

This step involves implementing the formulated portfolio strategy by buying or selling certain securities in specified amounts. This step is the one which actually affects investment results.

***(6) Portfolio Revision***

Fluctuation in the prices of stocks and bonds lead to changes in the value of the portfolio and this calls for a rebalancing of the portfolio from time-to-time. This principally involves shifting from bonds to stocks or vice-versa. Sector rotation and security changes may also be needed.

***(7) Performance Evaluation***

The assessment of the performance of the portfolio should be done from time to time. It helps the investor to realize if the portfolio return is in proportion to its risk exposure. Along with this, it is also necessary to have a benchmark for comparison with other portfolios that have a similar risk exposure.

**2. What are the investment vehicles?**

Making an investment includes putting money into stocks, bonds, mutual funds, real estate, or starting your own business. Each of these vehicles has positives and negatives. No matter what method you choose to invest, the goal is always to put your money to work so that it earns you an additional profit.

### 3. Investing is not Gambling

Investing is NOT gambling. Gambling is putting money at risk by betting on an uncertain outcome with the hope that you might win money. Part of the confusion between investing and gambling, however, may come from the way some people use investment vehicles.

### 4. Why Invest?

It is easy to understand that people invest because they want to increase their personal freedom, sense of security, and ability to afford the things they want in life.

However, investing is becoming less of an supplementary activity and more of a necessity. The days when everyone worked in the same job for 30 years and then retired to a nice fat pension are gone. For the average person, investing is not so much a helpful tool as the *only* way they can retire and maintain their present lifestyle.

### 5. What is Putting Money to Work?

The wonder of compounding (sometimes called "compound interest") transforms your working money into a state-of-the-art, highly powerful income-generating tool. Compounding is the process of generating earnings on an asset's reinvested earnings. To work, it requires two things: (1) the re-investment of earnings, and (2) time. The more time you give your investments, the more you are able to accelerate the income potential of your original investment, which takes the pressure off you.

*To demonstrate, let's look at an example:*

If you invest ₹ 10,000 today at 6%, you will have ₹ 10,600 in one year (10,000 × 1.06). Now let us say that rather than withdrawing the ₹ 600 gained from interest, you keep it in there for another year. If you continue to earn the same rate of 6%, your investment will grow to ₹ 11,236.00 (₹ 10,600 × 1.06) by the end of the second year.

Because you re-invested that ₹ 600, it works together with the original investment, earning you ₹ 636, which is Rs. 36 more than the previous year. This little bit extra may seems very little now, but let's not forget that you didn't have to lift a finger to earn that ₹ 36. More importantly, this ₹ 36 also has the capacity to earn interest. After the next year, your investment will be worth ₹ 11, 910.16 (₹ 11,236 × 1.06) .In the second year you earned ₹ 674.16, which is ₹ 74.16 more interest than the first year. This increase in the amount made each year is compounding in action-interest earning interest on interest. It will continue as long as you keep re-investing and earning interest. It is thus advantageous to start investing early.

**5. The three tests for investments**

Motives for investment may vary, but there are some common desires. We want our investments to give us some return. We want our money to be safe. And, in case of an emergency, we want our money back, quickly. Hence, there are three criteria to evaluate every investment avenue:

1. Safety
2. Liquidity
3. Returns

**7. Ideal Investment strategy?**

Even though all investors are trying to make money, they come from diverse backgrounds and have different needs. It follows that specific investing vehicles and methods are suitable for certain types of investors. Although there are many factors that determine which path is optimal for an investor, we'll look at three main categories:

*(a) Investment objectives,*

*(b) Timeframe, and*

*(c) Investing personality.*

**(a) Investment Objectives**

Generally speaking; investors have a few primary objectives:

- safety of capital
- current income and
- capital appreciation

These objectives depend on a person's age, stage/position in life, and personal circumstances. A 75-year-old widow living off her retirement portfolio is far more interested in preserving the value of investments than a 30-year-old business executive would be. Because the widow needs income from her investments to survive, she cannot risk losing her investment. The young executive, on the other hand, has time on his or her side. As investment income isn't currently paying the bills, the executive can afford to be more aggressive in his or her investing strategies.

An investor's financial position will also affect his or her objectives. A multi-millionaire is obviously going to have very different goals from a newly- married couple just starting out. For example, the millionaire, in an effort to increase his profits for the year, might have no problem putting down ₹ 100,000 in a speculative real estate investment. To him, a hundred grand is a small percentage of his overall worth. Meanwhile, the couple is concentrating on saving up for a down payment on a house, never mind a risky venture. Regardless of the potential returns there may be on a risky investment, speculation is just not appropriate for the young couple.

**(b) Timeframe**

As a general rule, the shorter your time horizon, the more conservative you should be. For instance, if you are investing primarily for retirement and you are still in your 20s, you still have plenty of time to make up for any losses you might incur along the way. At the same time, if you start when you are young, you don't have to put huge chunks of your paycheck away every month because you have the power of compounding on your side.

On the other hand, if you are about to retire, it is very important that you either safeguard or increase the money you have accumulated. Because you will soon be accessing your investments, you don't want to expose all of your money to volatility you don't want to risk losing your investment money in a market slump right before you need to start accessing your assets.

**(c) What is your personal characteristic?**

The personality trait that will determine your investing path is your desire to research investments. Thus, in addition to risk taking ability, some personal characteristics like, a cool temper, balanced outlook and data based decisions determine the success of an investment.

## 8. Forbidden/Unsafe Investments?

The following categories of investment are totally forbidden for all categories of investors:

- ❑ Chit funds, Nidhis, Ponzi Schemes, Mutual Benefit societies
- ❑ Phoney real estate schemes and plantation schemes
- ❑ Deposits with partnership firms, private limited companies and other companies who do not enjoy good credit rating.
- ❑ Speculative stocks and private placements of equity shares in companies promoted by unknown entrepreneurs.
- ❑ Volatile scrips which fluctuate rather dangerously
- ❑ Peerless-type savings schemes which use insurance jargon simply to confuse you
- ❑ New issues of shares by first generation unknown entrepreneurs.

*Some guidelines towards a strong financial future:*

The following are important steps towards ensuring a strong financial future:

- o Define your goals
- o Estimate your current financial position
- o Choose the investments according to your life stage
- o Diversify your investment to reduce risk
- o Do a lot of market research
- o Budget for your investment
- o Reduce the number of records. Instead of having too many unwanted bank accounts, demat accounts and unwanted investments, close the unnecessary ones. Keep one bank account in a branch nearby and preferably in Joint names
- o Have a cross power of attorney between spouses. This is valid during one's lifetime.
- o Make nominations in (a) Company's PF and your PPF accounts (b) LIC policies and personal accident policies (c) Gratuity (d) Superannuation schemes (e) Ownership flat (f) bank accounts etc.

- o Acquaint your spouse and family members with your financial arrangements, your advisers and consultants, and familiarise them with your files and documents.

## 9. Risks v/s Rewards

Risk is a real life fact for any investor. Stock markets may go down, companies may go bankrupt, inflation rates may soar or the government may not have enough funds to pay back. Therefore before making any investment you have to ask the question "What is the risk involved?"

It is important to measure one's risk tolerance, one's risk capacity and the risks v/s. returns associated with a particular investment so that you can allocate assets effectively without being overly cautious or too risky.

### (1) Types of Risks

1. *Macroeconomic risks:* Unfavourable political and economic developments can lead to a fall in the market.
2. *Market risks:* If there is a general decline in the markets, your investments will obviously suffer.
3. *Inflation risks:* If there is inflation and returns don't increase proportionately, then the money invested will not buy the same amount in the future.
4. *Liquidity risks:* If you want to sell off the investments, but nobody is buying it, the price will go down and you may not even recover the price you paid to purchase it.
5. *Sectoral risk:* If a particular sector/industry is adversely affected, then your investments in that sector/industry will be negatively affected.
6. *Company risk:* If a company you invested in has performed badly, the prices of securities of that company could go down and therefore the value of your investments will also go down.
7. *Interest rate risk:* It refers to the risk of the change in value of your investment as a result of movement in interest rates.

One should remember that every investment has risk attached to it. Only the degree of risk is different. One should analyze the risks to evaluate the returns that can be expected from an investment.

Returns across various asset categories have shown that equity shares give the highest level of returns in the long-term, followed by corporate bonds and deposits and lastly bank deposits and government debt.

The key to investment success is ideal diversification of assets. Diversification means more than just having different types of investments. It means having a right mix of investments across sectors, time horizons, markets, instruments and so on. A good portfolio will have stocks, bonds, mutual funds, money market funds etc. of different companies from different sectors. When you diversify, you spread your money among many different securities, thereby avoiding the risk that your portfolio will be badly affected because a single security or a particular market sector turns sour.

## 10. Portfolio and Diversification

### *(1) The Portfolio*

A portfolio is a combination of different investment assets mixed and matched for the purpose of achieving an investor's goal(s). Items that are considered a part of your portfolio can include any asset you own—from real items such as art and real estate, to equities, fixed-income instruments, and cash and equivalents. For the purpose of this section, we will focus on the most liquid asset types: equities, fixed-income securities, and cash and equivalents.

An easy way to think of a portfolio is to imagine a pie chart, whose portions each represent a type of vehicle to which you have allocated a certain portion of your whole investment. The asset mix you choose according to your aims and strategy will determine the risk and expected return of your portfolio.

*Basic Types of Portfolios*

- <u>Aggressive investment strategies</u>

  In general, such strategies that shoot for the highest possible return are most appropriate for investors who, for the sake of this potential high return, have a high risk tolerance (can stomach wide fluctuations in value) and a longer time horizon. Aggressive portfolios generally have a higher investment in equities.

- <u>Conservative investment strategies</u>

  The conservative investment strategies, which put safety at a high priority, are most appropriate for investors who have a lower risk tolerance and short time horizon. Conservative portfolios will generally consist mainly of cash and cash equivalents, or high-quality fixed-income instruments.

The main goal of a conservative portfolio strategy is to maintain the real value of the portfolio, that is, to protect the value of the portfolio against inflation. The portfolio you see here would yield a high amount of current income from the bonds, and would also yield long-term capital growth potential from the investment in high quality equities.

A moderately aggressive portfolio is meant for individuals with a longer time horizon and an average risk tolerance. Investors who find these types of portfolios attractive are seeking to balance the amount of risk and return contained within the fund. The portfolio would consist of approximately 50-55% equities, 35-40% bonds, 5-10% cash and equivalents. You can further break down the above asset classes into subclasses, which also have different risks and potential returns. For example, an investor might divide the equity portion between large companies, small companies, and international firms. The bond portion might be allocated between those that are short-term and long-term, government versus corporate debt, and so forth. More advanced investors might also have some of the alternative assets such as options and futures in the mix. As you can see, the number of possible asset allocations is practically unlimited.

***(2) Why Portfolios?***

Different securities perform differently at any point in time, so with a mix of asset types, the entire portfolio does not suffer the impact of a decline of any one security. When the stocks go down, you may still have the stability of the bonds in your portfolio. Spreading your investments across various types of assets and markets, helps you reduce the risk of catastrophic financial losses.

While putting away money for retirement, safety will be the most important criterion. A safe investment avenue that gives a decent annual return will be good enough. The money set aside for the down payment on your car, will be kept in your savings bank account so that you can withdraw it quickly.

Investing involves one well-defined time period for the returns you expect on your investment with a surety that you will get your returns. In other words investing does follow a method, it could be a method you adopt from a financial expert or could be self-defined.

The difference with speculation is about the degree. Once you invest, the difference will be more apparent. If you follow a method, you almost wipe out any chances of making losses, and making money is not that difficult. Often speculators succumb to the temptation of putting their money for short periods expecting to get rich quick. Some do succeed but it is all by fluke, and hence, what we see is that most of the losers are ones who fail to cap this temptation.

*Summary of Investment and Wealth Planning gives the following advantages:*

1. Defining return objective
2. Understanding risk tolerance
3. Investment constraints
4. Guidelines to construct a portfolio
5. Basis for portfolio monitoring and review
6. Better control over financial decisions
7. Allows perpetuity and solves disputes between client and adviser.

**Retirement Planning**

Retirement planning involves planning for the following;

- Allocation of finances for Retirement
- No Government sponsored retirement plan
- Nuclear Families
- Unforeseen Medical expenses
- Estate Planning
- The Flexibility to Deal with Changes
- Systematic investment every month is a way to a tension free healthy retirement.

**Steps to be followed in Retirement Planning**

- Decide on age for retirement
- Annual income need for retirement years
- Current market value of all the savings and investments
- Determine a realistic annualised rate of return
- Consider company pension plan if any
- Now compute the value required on retirement

**Retirement Investment Options**

- Public Provident Fund (PPF)
- National Savings Certificate (NSC)
- Employees Provident Fund (EPF)
- Mutual Fund Products
- Insurance Products
- New Pension Schemes
- Reverse Mortgage

***(1) Public Provident Fund (PPF)***

A PPF account is opened for an initial period of 15 years. That is, you make a commitment of 15 years upfront. This also means that you would not touch these funds for ad-hoc needs – which make PPF all the more suitable for goals like retirement planning. If you do not need the funds at the time of maturity (after 15 years), or cannot find a better investment avenue for these funds, you can opt to continue the PPF account. You can extend the PPF account for 5 years at a time, and you can have as many extensions as you want.

***(2) National Savings Certificate***

National Savings Certificate is a time-tested Tax saving instrument that combines sufficient returns with high safety. NSCs are an instrument for facilitating long-term savings. A large section of middle class families uses NSCs for saving on their tax, getting double benefits. They not only save tax on their hard-earned income, but also make an investment which is sure to give good and safe returns for their retirement.

### (3) *Employees Provident Fund (EPF)*

**What is Employee Provident Fund or EPF?**

Employee Provident fund or EPF is a fund made up of contributions by the employee during the time they have worked, along with an equal contribution from the employer. It is a calculated as a percentage of employee's salary (Basic Salary + DA + Retaining allowance), normally 12%, and returned upon retirement. In the absence of any social security cover for the elderly in India, employee provident fund not only provides monetary security and helps them meet daily living expenses; it also helps them live a life of dignity and respect after retirement.

**Is contribution towards Employee Provident Fund optional in India?**

All industries and establishments employing more than 20 people are required to contribute towards Employee Provident Fund (EPF).

*EPF Interest Rate*

The rate of interest for EPF is fixed by the Central Government every year during March/April. The interest is credited to the members' account on monthly running balance with effect from the last day in each year. The rate of interest is normally around 8.5%. However, the rate of interest for 2010-2011 was kept at 9.5%. The Employees' Provident Fund Organisation (EPFO) had brought down the rate of interest to 8.25 per cent for 2011-12 from 9.5 per cent provided in 2010-11. However, interest rate on employees' provident fund (EPF) was increased to 8.6 per cent for the financial year 2012-13 in April 2012. The Employees' Provident Fund Organisation (EPFO) may announce a higher interest rate on provident fund deposits for its over 5 crore subscribers in the current fiscal year (FY14) than 8.5 per cent provided in FY13

*Benefits of Provident Fund*

Apart from being a tool for our retirement savings, Provident Fund offers numerous more benefits:

- PF entitles you to get Pension

  As you must have seen in provident fund calculator above, 8.33% of employer contribution goes towards pension.

- Employee Provident Fund in India provides you insurance too – 0.5% of your monthly basic pay goes towards providing you insurance. The insurance cover is a maximum of—

  (1) 20 times the average monthly wage (maximum of ₹ 6,500) – which comes to ₹ 1,30,000.

  (2) Full amount in your PF account up to ₹ 50,000 and 40% of balance amount.

*Checking Provident Fund Balance Online*

Thanks to the initiatives by PF Department, provident fund balance can now be checked online (although currently data is available for a few locations only).

*Withdrawal from Provident Fund*

Premature withdrawal of the full amount of provident fund is allowed under following conditions:

- In case the of massive retrenchment in the organization, and employee being unable to find a job even after 60 days of leaving previous job, they can withdraw his provident fund.
- On migration from India to abroad for permanent settlement or for taking employment abroad.
- In case the employees of current establishment are transferred to another which is not covered under the Act.

  In any other case such as changing of jobs, etc, if the employee withdraws his complete provident fund, then he is liable to pay tax on it.

*Partial withdrawal of Employee Provident Fund in India*

A person who is a member of Employee Provident Fund can withdraw money upon reaching the age limit prescribed by the government- as of now, it is 55 years in India-or upon actual retirement. Additionally, provident fund may be withdrawn partially to meet expenses such as—

- Marriage of self, siblings or children
- Medical treatment of self or family
- Construction or Purchase of house or flat/site or plot

- Repaying of housing loan
- Repairs to an existing home

Please Note:

With effect from 1st April 2011, in case no contribution has been made in employee provident fund for 36 months, it will be identified as inoperative and no interest will be credited in such accounts.

### *(4) Mutual Fund Products*

Direct equity or mutual fund investments can also be used to create long-term capital, but prudence will have to be used, as such products do not have any fixed time horizon and maturity value. You will have to time the market correctly to maximise benefits.

Mutual funds (MFs) offer two kinds of retirement products—ones that offer tax deduction and other than don't. Let's call schemes that offer tax deduction type I and those which do not type II schemes.

Besides the difference in tax treatment, type I and type II schemes' investment patterns differ significantly. While type I schemes primarily invest in debt, irrespective of the age of investor, type II schemes mainly invest in equities until the time the investor nears the age of retirement. Typically, after the investor crosses 60 years of age, the fund begins to invest primarily in debt in order to secure your capital. You can make systematic or lump sum withdrawal during this stage.

There are two type I schemes in the market: Templeton India Pension Plan and UTI Retirement Benefit Fund. Both the schemes invest 40% of the corpus into equity and the balance into debt. These funds are relatively safe as a major part of the corpus is invested in debt, but they do not guarantee your capital.

On the other hand, type II schemes are being offered by several MF companies, including Birla Sun Life Asset Management Co. Ltd and ICICI Prudential Asset Management Co. Ltd. The newly launched Tata Retirement Savings Fund by Tata Asset Management Ltd also falls in the same category. Since type II schemes mainly invest in equities, the long-term returns may be higher as compared to type I scheme.

Assuming the same rate of return, type 1 schemes are better because of the tax deduction factor. Type 1 schemes tend to lose their edge only if the returns from equity are very high.

***(5) Insurance Products***

Retirement plans offered by life insurance companies are bundled products, offering the benefits of both insurance and investment. A typical retirement plan has two phases.

The first is the accumulation phase, during which you pay premiums and the money accumulates through the tenure of the plan. The accumulated money is then invested in securities approved by the Insurance Regulatory and Development Authority (IRDA), the insurance regulator.

These products are designed to protect the value of your principal while at the same time provide you with steady returns.

The accumulation stage is followed by the vesting age, which is the age when you start getting payouts from the kitty. This can be selected by you. The vesting age in most plans is 40 to 70 years. The period when a person gets pension is also called the annuity phase. During this phase, you can withdraw up to 33% of the accumulated amount at one go. The rest is paid as pension.

In the immediate annuity option, a person can pay in lump sum, instead of over the years, and start getting income immediately. The frequency of payments received can be monthly, quarterly, half-yearly or annually.

**Pension Products**

The New Pension System (NPS) has been conceived as a no-load product. It also has other investor-friendly features like full portability at no cost, which allows investors to switch fund managers.

With no inducement to push one fund over another, the point of sale will either allow the customer to make the product choice, or the customer will be put in a default option. (Default options are used to make the decision for the customer who would rather not choose. The NPS uses a well-regarded, lifecycle-based investing formula that reduces the equity allocation of a person as they age.) The NPS could have taken the route of higher sales commissions than insurance to get market share, but it has chosen an ethically mature path, risking a slow start to the product off-take in the market.

A retirement corpus can be built during the working life of a person by regularly contributing (the minimum amount being ₹ 6,000 p.a.) to the NPS till the age of 60. Such contributions are invested by the Pension Fund Manager (PFM) the investor chooses, in the investment option of his choice namely active choice and auto choice.

**Active Choice**

- Asset Class E (Equity): Invests in index funds (the maximum allowed is 50%, the balance has to be in Asset Class G & C)
- Asset Class G (Government securities): Invests in central and state government bonds
- Asset Class C (non-government debt): Invests in liquid funds of Asset Management Companies, bank fixed deposits, rated bonds issued by corporates, banks, financial institutions, PSUs, Municipality and Infrastructure entities

**Auto Choice (Life cycle fund)**

The contributions are automatically allocated to the three asset classes in a predefined manner depending on the investor's age. Upon subscribing, the investor is allotted a Permanent Pension Account Number (PPAN). The PPAN will remain constant even if the investor changes the PFM, his location or employer. The returns earned on the contributions would depend on the investment option. Charges are applicable to the NPS account as prescribed by the regulator-Pension Fund Regulatory and Development Authority (PFRDA). For further details, visit **www.pfrda.org.in**

Annuity/Pension Policies/Funds are products of the insurance companies and offer guaranteed income either for life or for a certain period without any insurance cover.

**Estate Planning**

The sum of all the assets of a person, less his liabilities becomes his ESTATE. For examples all properties, bank accounts investments, insurances and collectibles, less the liabilities of a person are collectively called a person's estate. Estate planning is about

- Accumulating and Disposing of an estate to maximize the goals of the estate owner.
- Distributing wealth to a certain beneficiary or beneficiaries to whomever the owner wishes.

- Taking the help of an attorney experienced in estate law

**Objectives of Estate Planning**

- Asset transfer to beneficiaries
- Tax-effective transfer
- Planning in case of disabilities
- Time of distribution can be pre-decided
- Business succession
- Selection of Trustee or guardian or the executor

**Terminologies in Estate Planning**

- **Will –** A document that conveys your wishes about your estate and helps in following it after your death
- **Testator –** A person who makes his/her will
- Executor – A person who executes the will after the death of the testator
- **Legatee/Beneficiary –** A person who inherits the estate under a will.
- **Intestate –** A person who dies without making a valid last will is said to have died intestate
- **Probate –** A legal process of settling the estate of a deceased person
- **Power of Attorney –** An authorization to act on someone else's behalf in a legal or business matter.
- **Trust –** It is a relationship in which a person called the trustor transfers something of value, movable or immovable to another person called a trustee. The Trustee then manages and controls these assets for the benefit of a third person called a beneficiary.

**Steps and Tools in Estate Planning**

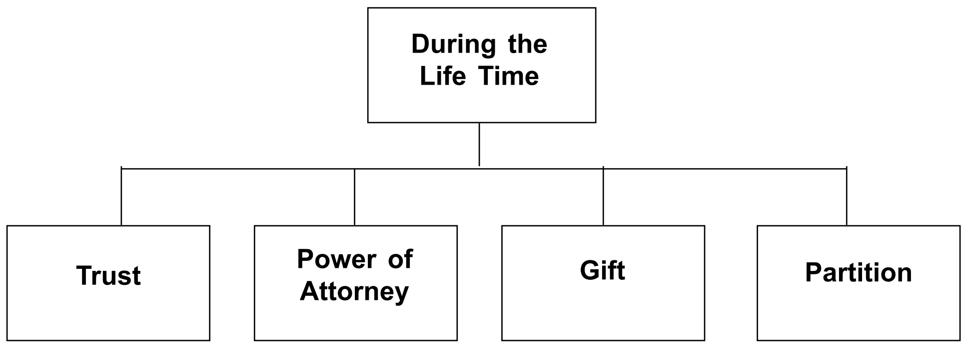
- Steps
  - Listing of assets and liabilities
  - Open family discussion on selecting the guardian
  - Update the current beneficiaries like life insurance

  - Decide upon the distribution of the assets on death
  - Funeral arrangements with spouse and family
  - Assistance of an estate planning authority

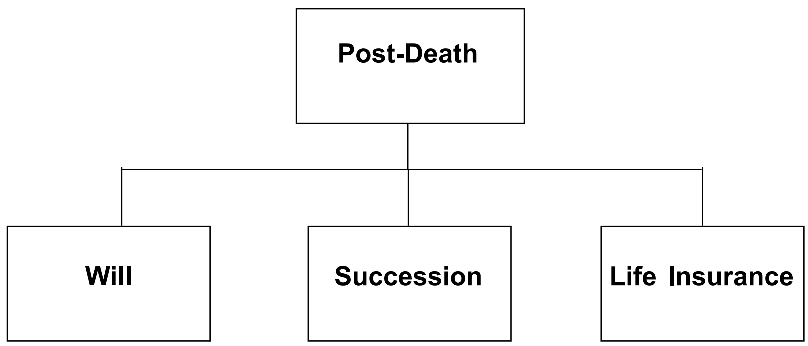
- Tools
  - Life Insurance
  - Will
  - Trust

There are various tools that a financial planner can adopt for getting an estate plan in place. Some tools are effective during the lifetime of an individual while some after his/her death.

The following figure shows the tools used for estate planning by transferring the assets to the beneficiary, with or without restrictions, during the lifetime of an individual




The following figure shows the tools used for estate planning where



the transfer of assets to the beneficiary becomes effective after the death of an individual

**Life Insurance as Estate Planning Tool**

Insurance policies, such as whole-life covers, can be vital assets that you leave behind for legal heirs and/or nominees. They represent a large corpus of funds that can be of immense use to your next of kin/ nominee/legal heir after you have gone on. Plus, you have the feeling of contentment that comes from doing what is right for them.

Whole-life insurance plans provide insurance throughout your life or up to a specified pre-determined age. The maximum age of coverage differs from insurer to insurer. The maximum age of expiry for a whole-life policy could be as late as your 99th birthday.

The sum assured is paid out to the nominee on your death, Or to you, if you survive till the predetermined age. Whole-life policy payouts include the sum assured (i.e. death benefit) as well as bonus accrued in the course of the policy tenure. The whole-life policy works on the principle that you are not entitled to any payout during your lifetime. That is, there is no survival benefit to the policyholder. It represents value accrued throughout your life, bequeathed to your legal heir/ nominee.

But here's a surprise! If you are to survive till the almost-impossibly high predetermined age, congratulations, you have earned the right to keep the payout. In this event, consider the payout as a gift for the long life you have managed to lead. A very nice birthday present indeed. As an estate planning tool, the whole-life policy is the best in the insurance stable.

But, (and it is an important 'But') the whole-life policy you choose should have the least investment component in its premium break-up It will work as an estate planning tool only if you keep to certain conditions: the policy. This should be easy to find out. Compare whole-life premiums across insurers. The insurer giving you the smallest premium quote for the same sum assured and tenure will have the least investment component.

Remember, an insurance product is not an ideal investment vehicle. Returns from insurance plans rarely beat inflation, never mind positive year-on-year rates of return. Therefore, why would you want to pay extra premium towards something that is going to be a bad investment when even basic investment or savings avenues such as the public provident fund (8 per cent annualised return, guaranteed by the Government of India) pay more.

Buy the whole-life policy that also has the longest term. Remember, you haven't bought a whole-life plan for your benefit - it is primarily an estate for your heirs. The longer the term of the policy, the lower will be the premium, i.e. maximum benefit at the least cost. Also, buy the whole-life policy that allows you limited premium payment facility.

Insurers offer whole-life plans that allow you to pay premiums for just the first 20 years of a 50-year plan. This means, you have sewn up payment on your plan during your working years, but remain covered long after you have retired. Think twice before purchasing any asset or policy. When it comes to the insurance component of your estate, your focus should be on lending a helping hand to your legal heirs. At the end of a productive life, you can pass on in peace, secure in the thought that you have left your dear ones in financial comfort.

**Will as Estate Planning Tool**

**1. What is a "Will"?**

"WILL" signifies the wish, desire; choice etc. of a person intended to take effect after his death. It is a legal declaration and the direction of and by a person of his intention with respect to matters which are within his domain and which are within his disposing capacity to be carried out after his death. Once a person writes his wishes regarding his property on the paper and puts his signature and is witnessed by two witnesses, the document becomes his "WILL".

**2. Legal terms in a "Will"**

| | |
|---|---|
| Testator | A person making the "Will" |
| Legatee or Beneficiary | A person to whom assets are bequeathed under a "Will" |
| Executor | A person appointed by the Testator to execute the "Will" as per the provisions of the "Will" |
| Legacy | A benefit under a "Will" |
| Codicil | A document which modifies or alters the contents or provisions of the original "Will" |
| Attestation | An act of witnessing the execution of the "Will" |

| | |
|---|---|
| Probate | A copy of the "Will" certified under the seal of a Court of competent jurisdiction with a grant of administration to the estate. |

**3. What are the advantages of making a "Will"?**

(a) There will be clarity amongst the successors as to who will receive what.

(b) Life is uncertain and a "Will" can make your last wishes come true.

(c) A "Will" reduces unpleasant succession disputes which arise if the head of the family dies intestate.

(d) One can maintain secrecy till his lifetime.

(e) If one doesn't make a "Will", the Personal Law will follow and the property will be distributed as per the Personal Law. Thus there will be no scope for tax planning, charity, etc.

**4. Who can make a "Will"?**

Any person who attains the age of Majority and who is of sound mind can make a "Will".

*Age:* As per Indian Majority Act 1875, where a guardian of the minor's property has been appointed by a court of law, he will be deemed to be a minor till he is 21 years of age and in all other cases up to 18 years of age a person is considered as a minor.

*Soundness of mind:* As far as soundness of the mind is concerned, no definition of soundness is given. The test of soundness of mind is a workable test, neither hypothetical nor impractical. Soundness of mind denotes the mental capacity of the testator as to what he is doing, his capability of understanding his wealth and what he is giving. However soundness of mind does not depend on the age.

If these two conditions are satisfied he/she can make the "Will".

**5. What are the salient features of a "Will"?**

The following are the salient features of a "Will":

- It can be on a plain paper. No stamp paper is required for making a "Will".

- Modifications and alterations (including revocation of "Will") can be done for 'N' number of times. The last ""WILL"" made will prevail on all the earlier "Will's.
- No other person is legally competent to interfere with it or to modify it in any mode or manner.
- A "Will" must be signed by the person who is making it.
- There must be at least two witnesses to the "Will". The witness should not be the beneficiary under that "Will" and he must be of sound mind and of majority age.
- There isn't any standard format for the "Will", but since decades the format used in England has been in vogue in India .The Language of the "Will" should be simple & free from any ambiguity. It must contain all the details of the property and recipient of the property.
- "Will" is such a unique document that comes into operation when the writer is no more. Hence some precautions are necessary. For example, to prove that the testator is of sound mind, it is advisable if the family doctor himself signs as witness to the "Will".
- The "Will" should not be prepared under duress or under influence.
- Personal law also needs a consideration. For example, a Hindu must provide for maintenance of his wife and children and a Muslim cannot go beyond his religious law and can distribute only 1/3rd of his property as per his wish.
- This is a function that cannot be assigned or delegated to some body. Every person has to sign his "Will". He cannot make his legal representative sign or make a "Will" on his behalf.
- In case of soldiers/mariners/persons on death bed there can be oral "Will" but it is in very special circumstances.

**Trusts as an Estate Planning Tool**

In a Trust, a person transfers his property to another person i.e. the Trustee to hold it for the benefit of certain beneficiaries; or it can be for the benefit of beneficiaries and himself/herself. By adopting a Trust Route, a person can avoid the issues which arise in a Will and make a ring fenced structure to ensure that the person's future generations are well- protected through a vehicle created by him and according to his directions.

*Characteristics of Trust Structures are as follows:*

(*a*) Title to the Trust property gets transferred to the name of the Trustee.

(*b*) The Trust property constitutes a separate fund and is not a part of Trustee's own estate.

(*c*) The Trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the Trust property in accordance with the terms of the trust and the special duties imposed upon him by law. There exists a fiduciary relationship between Trustee and the beneficiaries and thus the Trustee exercises a higher duty of care then a mere agent. The Trustee shall hold the ownership of Trust properties for the benefit of another or for another & the owner but never for the benefit of the owner alone. The owner who settles the Trust can be one of the beneficiaries.

(d) A Trustee's ownership is not an absolute ownership as known to law (i.e. trustee's ownership is the legal ownership not the beneficial ownership).

**Benefits of Estate Planning by Creation of Trust Structures**

By adopting the Trust Structure for planning one's estate the following objectives can be achieved:

- Estate Protection as Trust is a bankruptcy remote structure.
- Self-Beneficiary — The person who creates the Trust can himself be one of the beneficiaries and enjoy the benefit of his own estate during his lifetime.
- Efficient Succession Planning by providing for children, grandchildren and great grandchildren.
- Management of all types of assets done through expert advisers.
- Accumulation of the Estate during the lifetime and post death done through the Trustees.
- Avoidance of family disputes leading to disintegration of family businesses.
- Retaining confidentiality, as obtaining a Probate is not necessary.

- Causing efficient management of the Estate as a trust can be made operational during the lifetime and after death of the Client.
- Providing for future administration of assets to protect against future incapacity and incapable beneficiaries.
- Making provisions for religious or charitable purposes.
- Lower Contestability as compared to a Will.

**Tips in Estate Planning**

Following are some points one must check in the "Will", otherwise it will create chaos and problems afterwards or it may defeat the very purpose of the "Will".

(*a*) It must be signed by two (2) witnesses who are of the age of majority and should not be the beneficiaries under that "Will".

(*b*) When you appoint a person as an Executor to the "Will", before appointment, take his consent. Appoint more than one Executor and handover to each Executor one sealed copy of the "Will". In case you wish to have a Registered "Will", then inform the Executor where you have registered your "Will".

(*c*) Prepare the list of all Assets and Liabilities and mention them in the "Will". In addition to this, always have a residual clause in the "Will".

(*d*) Even though it is not compulsory, it is advisable to have the "Will" neatly typed and drafted beyond ambiguity.

(*e*) It must be revised every three (3) years, because in that span of the period, many changes might take place like assets may increase/decrease, beneficiaries may increase or decrease.

(*f*) Whenever you want to change your "Will", you can do so by making a codicil, but it is better if you make a fresh "Will". Don't give the "Will" to the beneficiaries to read because their attitude towards you may change. Let it be suspense for the beneficiaries.

(*g*) It is advisable to make "will" for self and spouse separately.

(*h*) A "Will" may be registered with the Sub-Registrar of Assurances office.

Although it is not necessary to register a "Will", it adds protection, validity and secrecy to the "Will".

Instead of registering a "Will" any of the following precautions may be taken

- Give the "Will" to the Executor in a sealed envelope.
- You may have joint locker in the bank, and keep it there.
- Give it to your consultant or Chartered Accountant.
- Keep with any other trustworthy person.
- Give it to the main beneficiary. In that case the main feature of "Will" i.e. "SECRECY" will be lost.

**The tax Impact**

❖ Transfer of assets under a "Will" isn't considered a transfer and hence is a tax-neutral transaction.

❖ However when the beneficiaries sell the inherited assets, it will attract tax based on their taxable income and the classification of the assts as a business/capital asset.

❖ Until such time as the assets are transferred to the beneficiaries, the income from such assets will be assessed in the hands of the executor as representative taxpayer.

❖ Through "Will" trust of new HUF can be created which are separate taxable entities.

**c. How does Financial Planning help?**

- The first benefit will be that you will set realistic financial and personal goals.
- It helps you assess your current financial status by examining your assets, liabilities, income, insurance, taxes, investments and estate plan.
- You will develop a realistic, comprehensive plan to meet your financial goals by addressing financial weaknesses and building on financial strengths.
- You will realize the benefits only when you put your plan into action and monitor its progress.
- You will stay on track and be sufficiently informed to meet the changing goals, personal circumstances, stages of life, products, markets, and laws.

**d. When should one opt for Financial Planning?**

When it comes to taking a financial planning advice, there is nothing called right time. On the contrary it is always right to have a financial planning. As long as you have income and assets to manage, it is always a good idea to take professional help. It helps you to understand what financial planning is all about; it also helps you to realize whether your current planning, if any, serves your requirement in the long run.

**e. What is the Role of a Professional Financial Planner?**

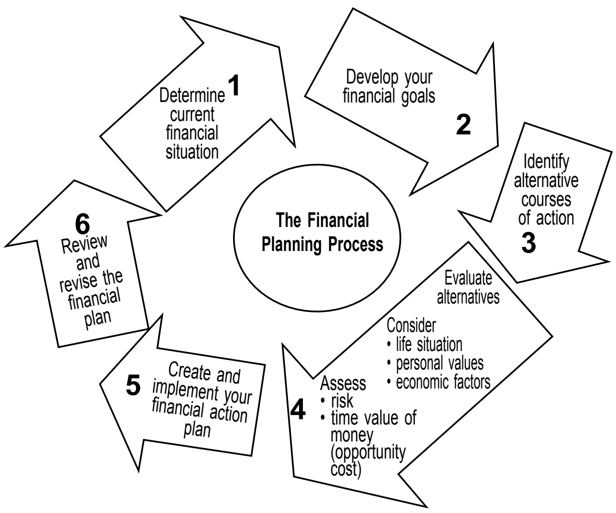
The Role of a Professional Financial Planner is that of a doctor who, not just helps you treat infections but also tells you what precautions to take against them. In other words, a professional planner not only understands your financial position, you near future requirement and long term ear marked goals, he is also aware of the latest investment products in the market and also a feedback on the most trusted products for investment and savings. Adding to it, he has the experience of planning for a large number of customers, and hence will be the right person who can help you plan your financial goals, what precautions to take and also helps you reap the benefits of a careful financial planning exercise.

**f. Why Financial Planning is called an 'Art'?**

Financial Planning requires a careful consideration of current and future financial requirements keeping in mind the income of the individual with a tab on his/her expenditure and commitments. There should be a balance of long term and short term savings as well. The reserve money should be invested in carefully selected investment products to ensure safety and stability of returns. Hence, ideally, it demands the dedication required in making an artefact.

**g. The Financial Planning Process**

**The Financial Planning process consists of the following basic six steps**



### *(1) Determine Current Financial Situation*

In this first step of the financial planning process, you will determine your current financial situation with regard to income, savings, living expenses, and debts. Preparing a list of current asset and debt balances and amounts spent for various items gives you a foundation for financial planning activities. It is something similar to preparing your current Balance Sheet on the basis of how much of assets and liabilities you have on you.

Your Balance Sheet could be as follows:

*Assets*

| | |
|---|---|
| Residential House | ₹ 50,00,000 |
| Car | ₹ 10,00,000 |
| Securities | ₹ 2,00,000 |
| Mutual Funds | ₹ 5,00,000 |
| Bank Balance | ₹ 3,00,000 |

Total assets thus of worth 70 lakhs.

*Liabilities*

| | |
|---|---|
| Capital | ₹ 27,00,000 |
| Home Loan | ₹ 35,00,000 |
| Car Loan | ₹ 5,00,000 |
| Personal Loan | ₹ 3,00,000 |

Total liabilities worth 70 lakhs.

### *(2) Develop Financial Goals*

We all have financial dreams. It could be buying the dream house, car, going on an extensive holiday, retirement planning, and children education and so on. This is a very vital and difficult task. Most people don't know what they want in life. It's time to pen down what you want. Also, like every goal, it's important that it should be measurable, realistic and having a definite time frame. You should periodically analyse your financial values and goals.

### *(3) Identifying alternate courses of action*

Considering the current financial situation and understanding the financial goals to be achieved, it's time to chalk out alternate courses of action to achieve the goal. Now it's essential to find a balance between the present and the future: How much of present lifestyle has to be sacrificed for attaining future goals.

### *(4) Evaluating the alternate courses of action*

Risk profiling is very important at this stage. What is the ability and willingness of the person to take risk? Also what are his personal likes and dislikes?

- You need to evaluate possible courses of action, taking into consideration your life situation, personal values, and current economic conditions.
- *Consequences of Choices.* Every decision closes off alternatives. For example, a decision to invest in stock may mean you cannot take a vacation. A decision to go to school full time may mean you cannot work full time. Opportunity cost is what you give up by making a choice. This cost, commonly referred to as the trade-off of a decision, cannot always be measured in dollars.
- Decision making will be an ongoing part of your personal and financial situation. Thus, you will need to consider the lost opportunities that will result from your decisions.

### *(5) Creating and implementing a financial plan*

- In this step of the financial planning process, you develop an action plan. This requires choosing ways to achieve your goals. As you achieve your immediate or short-term goals, the goals next in priority will come into focus.
- To implement your financial action plan, you may need assistance from others. For example, you may use the services of an insurance agent to purchase property insurance or the services of an investment broker to purchase stocks, bonds, or mutual funds.

### *(6) Monitoring and revising the plan*

- Financial planning is a dynamic process that does not end when you take a particular action. You need to regularly assess your financial decisions. Changing personal, social, and economic factors may require more frequent assessments.
- When life events affect your financial needs, this financial planning process will provide a vehicle for adapting to those changes. Regularly reviewing this decision-making process will help you make priority adjustments that will bring your financial goals and activities in line with your current life situation.

# VIII. THE ART OF INVESTING

### Invest your Savings

There are three things that you need to consider before investing your savings.

- o Percentage of Savings retained for Contingencies and other Emergencie, if any
- o Investments having a Short-Term Tenure
- o Investment having a Long-Term Tenure

The percentage of savings retained from being invested should be sufficiently large to ensure a strong base and big enough to absorb all contingencies of the immediate future. Investments having short term tenure include fixed deposits, Bonds, Debentures. Investments having long- term tenure include Gold, Real Estate, Equities, Debt and Alternative Investments like Private Equity.

### Growing Money

Investing money, in short, is in putting money to work. As said earlier, Money is the only non-living thing that grows when put to work. Again, it is important to note that long term investments actually pave the way for the money to grow. Does it mean short term investments don't? The reason behind lauding long- term investment is that, it takes into account the ups and downs and balances the peak and lean period, therefore the money actually tends to grow giving a compounding effect to money.

### Money kept idle loses Value

It is also important to note that money that is kept idle loses its value. Thanks to inflation, the real value of money depreciates and hence putting them in savings accounts is the least you can do to save money from depreciating.

### Retained Earnings

Good that you earn money and also decide to retain some of it and what do you do after it? You Invest. Basically you make the money work for you. Investments can be classified into safe and risky ones. While safe investments earn lesser return, risky ones get greater returns.

**What do you want from Investing?**

- o Huge Returns
- o Value appreciation
- o More money than before

**Seldom do all our expectations come true.**

**What should you remember while investing?**

- o When you start investing, expect nothing for a year or so, especially in stocks
- o In short, invest only what you can lose.
- o Analyse the cause of your loss
- o It is important to develop **knowledge** about investing and about the sector in which you intend to invest. Knowledge matters.
- o This gives you an edge over others and helps you succeed in an investment decision.
- o Always keep tab on the financial news and information and if required even take a few courses on investments, it is likely to give you a good insight into investing.

**a. GOLDEN RULES ON INVESTING**

- o Start saving soon and investing early
- o Invest at Regular Intervals
- o Always aim at long-term investments
- o It is always important to diversify investments.

**Steps to consider before INVESTING your Savings**

The after saving and pre investing phase should take care of the following

- o **A liquid fund for contingencies** is set apart (this amount should not be considered for investment though this should be either kept as a bank balance or deposit)
- o **A liquid fund for immediate requirements** is developed (this amount should not be considered for investment as they are meant for an expenditure quite immediate)

- **Basic Insurance,** is required. It is always suggested to have a term plan that comes with a lesser premium when compared with a life insurance with sum assured for the same amount.

- **Usage of Credit to be kept minimum** as the credit not only eats up your savings, it also creates more liability ( using credit card factually means expending money out of your future earnings, which is not worth practicing)

- **A fund for your Retirement** is absolutely essential. A fixed sum of money accumulated towards a retirement reserve is crucial to ensure peaceful retirement for you and your spouse ( This is especially important when you have no retirement corpus accumulated by your employer)

**Considerations for Planning your Investment Strategy**

Investing as a job requires certain things to be planned. The following points should be considered before formally beginning your investment

- Write down your investment goals

- Time that you can allocate to pursue your investment goals

- What is the level of your knowledge with regard to investments and investing?

- Funds available for investment purposes

- To what extent can you take losses without affects other considerations

- Your today's financial position

- What is the level of your risk tolerance? (low, medium, high)

**General Cautions while Investing**

1. *It is important to get details especially written documents explaining more about the investment you consider*

2. *It is not only important to read such documents and understand them, it is equally important to verify their authenticity*

3. *Before you decide to make an investment, know the cost associated with it and subsequent benefits you are about to receive*
4. *Any investment should be assessed for its liquidity aspect together with their safety*
5. *The above aspects will enable you to analyse whether the investment under consideration is an appropriate for your investment goals*
6. *Also check how this particular investment goes with the other investments you have already made or about to make*
7. *If the investment requires you to deal through an intermediary, ensure you operate through an authorised intermediary*
8. *Enquire and thoroughly research about the intermediary*
9. *Know what to do if something goes wrong with your investment, know your options and avenues, proceed only if satisfied*
10. *Never invest money you need in the Short-Term*

**b. Investment Objective**

There are 3 basic investment objectives:

- Safety
- Returns and
- Liquidity

It means that one would like the investment to be absolutely safe, while it generates handsome returns and also provides high liquidity. It is rather very difficult to maximise all three objectives at the same time. A trade-off is required. If one wants high returns, one may have to take some risks; or if one wants high liquidity, one may have to compromise on returns.

**c. Asset Class**

There are investment opportunities that are high on risk and there are investment opportunities that are low on risk. Each is called an asset class. An investor needs to allocate his savings to one or more asset classes depending upon his circumstances.

| Investment Option | Returns | Liquidity | Safety | Active Involvement | Amount Required |
|---|---|---|---|---|---|
| Equity Shares | Low to High | Moderate to High | Low | Yes | Medium |
| Debentures | Moderate | Low | Moderate | No | Medium |
| PSU/FI Bonds | Moderate | Moderate | High | No | Low |
| RBI Tax Free Bonds | Moderate | Moderate | High | No | Low |
| Debt Mutual Funds | Moderate | High | Moderate | No | Low |
| Equity Mutual Funds | Low to High | High | Low | No | Low |

### d. Categorising Investments and Criteria for Selection of Investments

There are parameters one should look at based on their individual status. The following can be considered a thumb rule for investing

| | Students | Salary Earners Private | Salary Earners-Government | Professionals | Traders | House-wives | Retired Persons |
|---|---|---|---|---|---|---|---|
| **Returns** | VI | VI | I | VI | VI | I | I |
| **Liquidity** | LI | I | I | LI | LI | I | I |
| **Safety** | I | I | VI | I | I | VI | VI |
| **Tax Saving** | LI | VI | I | VI | VI | LI | LI |

VI: Very Important I: Important LI: Less Important

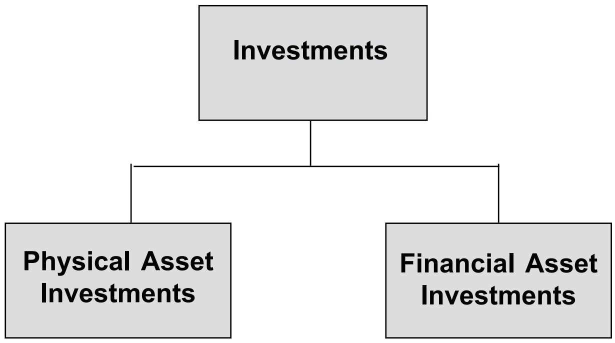
### Age of the Investor and Asset Allocation (Mix)

Perfect asset allocation is the one that suits your profile. A key factor in determining your investing profile is your age. Well age is not the only factor to take into consideration; you can manage your asset allocation according to your age.

While younger investors are better off with a portfolio featuring more stocks with greater growth opportunities,older investors nearing retirement should prefer portfolios with a greater percentage of fixed income and reliable revenue streams with a very small proportion of stocks with their associated risks.

An asset allocation involves several rules of thumb. A common suggestion is to invest your age in bonds. Say you are a 40 year old, you may use a 40/60 (bond/equity) allocation. Though it might seem a little conservative for young people, it is a slightly risky adventure for people above 40 years.

**e. Classifying Investments**




- **Physical Asset Investments**

  Investments in the following are considered as Physical Asset Investments

  - Real Estate Investments
  - Commodities Investments
  - Investment in Gold
  - Investment in Jewellery
  - Investment in Precious Stones

- **Financial Asset Investments**

  Investments in the following are considered as Financial Asset Investments

  - Bank Deposits
  - Fixed Deposits
  - Post Office Investments
  - Insurance Policies
  - Public Provident Funds
  - Pension Fund Schemes
  - Mutual Funds
  - Shares
  - Bonds
  - Debentures

**Entities and their Regulatory Bodies**

| Type of Entity/Activity | Regulatory body | Website |
|---|---|---|
| Auditors | ICAI/CAG | www.icai.org<br>www.cag.gov.in |
| Banks | RBI | www.rbi.gov.in |
| Banks — Issue Collection | SEBI | www.sebi.gov.in |
| Chit Funds | REG. OF CHIT FUNDS | — |
| Collective Investment Schemes | SEBI | www.sebi.gov.in |
| Companies — All | MCA/ROC | www.mca.gov.in |
| Companies — Listed | MCA/ROC/SEBI/SE | www.mca.gov.in<br>www.sebi.gov.in |
| Company Secretaries | ICSI | www.icsi.edu |
| Competition | CCI | www.cci.gov.in |
| Co-operative Banks | RBI | www.rbi.gov.in |
| Cost Accountants | ICWAI | www.icwai.org |
| Credit Rating Agencies | SEBI | www.sebi.gov.in |
| Custodial Services | SEBI | www.sebi.gov.in |
| Debenture Trustees | SEBI | www.sebi.gov.in |
| Depositories | SEBI | www.sebi.gov.in |
| Depository Participants | SEBI/NSDL/CDSL | www.sebi.gov.in<br>www.nsdl.co.in<br>www.cdslindia.cum |
| Foreign Investment Institutions | SEBI | www.sebi.gov.in |
| Housing Finance Companies | NHB | www.nhb.org.in |
| Insurance Brokers/Agents | IRDA | www.irdaindia.org |
| Insurance Companies | IRDA | www.irdaindia.org |
| Investment Bankers | SEBI | www.sebi.gov.in |
| Investor Associations | SEBI | www.sebi.gov.in |
| Media (Print/Electronic) | MIB | www.mib.nic.in |
| Mutual Funds | SEBI | www.sebi.gov.in |
| Mutual Fund Brokers/Agents | SEBI/AMFI | www.sebi.gov.in<br>www.amfiindia.com |
| New Pension Scheme (NPS) | PFRDA | www.pfrda.org.in |
| Non-Banking Financial Companies | RBI | www.rbi.gov.in |
| Nidhi Companies | MCA | www.mca.gov.in |

| Type of Entity/Activity | Regulatory body | Website |
|---|---|---|
| Plantation Companies | SEBI | www.sebi.gov.in |
| Portfolio Managers | SEBI | www.sebi.gov.in |
| Registrars/Share Transfer Agents | SEBI | www.sebi.gov.in |
| Serious Frauds | SFIO | www.sfio.nic.in |
| Stock Brokers | SEBI/SE | www.sebi.gov.in |
| Stock Exchanges | SEBI | www.sebi.gov.in |
| Sub-Brokers | SEBI | www.sebi.gov.in |
| Venture Capital Funds | SEBI | www.sebi.gov.in |

# IX. KNOWLEDGE ON INVESTMENTS

**The Asset Allocation**

**EQUITY**

- Comprises – Shares & Stocks
- Variety – Blue Chip, Growth Stocks, Income Stocks, Cyclical Stocks, Defensive Stocks, Speculative stocks
- Advantage – Greater returns, diversification, liquidity, information, tax benefits, appreciation, dividends, pledge, voting
- Regulator – BSE, NSE,
- Markets – Primary & Secondary, Online Trading
- Investors – Retail Institutional Investors, Non-Institutional Investors, Qualified Institutional Buyers

**Capital Market Investments**

- ***Equity Shares***

  An appropriate investment avenue for an investor who are is prepared to take risks for higher returns. Over the long term, returns from equity shares at aggregated levels are generally higher than most other avenues.

- ***Primary Market Purchase of Securities***

  An issue is called an Initial Public Offering (IPO) when an unlisted company makes a fresh issue of shares or some of its existing shareholders make an offer to sell off part of their existing shareholding for the first time to the public. An IPO of fresh shares is made by a company when there is a need for money, for the purposes of growth-expansion or diversification or acquisitions or sometimes to meet its increasing working capital requirements.

  ***What is Further Public Offering (FPO)?***

  When an already listed company makes a fresh issue of securities to the public or the existing promoters make an offer for sale to the public it is referred to as Further Public Offering (FPO).

***When it is made?***

Fresh securities are issued by a company when it needs money for

- growth-expansion or
- diversification or
- acquisitions or
- even to meet its increasing working capital requirements.

It is important to note that the FPO route is also being utilized extensively by the Government for the PSUs for the purpose of disinvestment of government's holdings.

**Investing in IPOs/FPOs**

**DOs**

✓ Read the Prospectus/Abridged Prospectus carefully, with special attention to:

  o Risk factors
  o Background of promoters
  o Company history
  o Outstanding litigations and defaults
  o Financial statements
  o Object of the issue
  o Basis of Issue price
  o Instructions for making an application

✓ Always use the ASBA process for applying — Wherein the investor authorises his bank to block in his bank account an amount equivalent to the application money. While the money remains in the bank, on finalisation of the basis of allotment, only the amount equivalent to the allotment amount is debited to the bank account, and the remaining amount is open for regular use.

✓ Where one has not received the credit to DEMAT account/ refund of application money, it is important to lodge a complaint with compliance officer of the issuer and with post-issue lead manager for further follow up and action.

**DON'Ts**

- ✓ Never be influenced by any implicit/explicit promise made by the issuer or anybody else
- ✓ Never invest based only on the prevailing bull run of the market index or of scrips of other companies in the same industry or scrips of the issuer company/group companies
- ✓ Never expect the price of the shares of the issuer company to necessarily go up upon listing or forever

- **Secondary Market – Purchase of Securities**

  It is a market where the issued shares and bonds/debentures are sold and bought among investors through a broker of a stock exchange.

**Investing in the secondary market**

**DOs**

- ✓ Check the credentials of the company, its management, fundamentals and recent announcements made by them and other disclosures made. The main source of information are the websites of the exchanges and companies, databases of data vendors, business newspapers and magazines
- ✓ Go for trading/investment strategies commensurate with your risk-bearing capacity as all investments carry some risk, the degree of which varies according to the investment strategy adopted
- ✓ It is important to transact only through SEBI-recognised stock exchanges and deal only through SEBI-registered brokers/sub-brokers
- ✓ Ensure you provide clear and unambiguous instructions to your broker/sub-broker/DP
- ✓ Make sure to insist on a contract note for each transaction and verify details in the contract note, immediately on receipt. Crosscheck details of your trade available with the details on the exchange's website
- ✓ Make sure that the broker's name, trade time and number, transaction price and brokerage are shown distinctly on the contract note given.
- ✓ Issue cheques/drafts only in the trade name of the broker

- ✓ Ensure delivery of shares/depository slip in case of sale and pay the money in case of purchase within the prescribed time
- ✓ Ensure receipt of payment/deliveries within 48 hours of payout
- ✓ Get periodical statement of accounts
- ✓ Take time to scrutinise both the transactions and the holding statements that you receive from your DP
- ✓ The Delivery Instruction Slips (DIS) Book issued by the DP should be carefully maintained. It is important to insist that the DIS numbers are pre-printed and your Client ID is pre-stamped
- ✓ One can use the freezing facility in the demat account where it is not being used.

**DON'Ts**

- ✓ Never forget to take account of the potential risks that are involved in investment in shares
- ✓ Never go for off-market transactions
- ✓ Never deal with unregistered intermediaries
- ✓ Never fall prey to promises of unrealistic returns or guaranteed returns
- ✓ Never invest on the basis of hearsays, rumours and tips
- ✓ Never be influenced into buying into fundamentally unsound companies
- ✓ Never should you blindly follow investment advice given on TV channels/websites/SMS
- ✓ Never invest under pressure or imitate investment decisions of others who may have profited from their investment decisions
- ✓ Never get misled by companies showing approvals/ registrations from Government agencies as the approvals could be for certain other purposes
- ✓ Never should you get carried away with advertisements about the financial performance of companies

- **What is a Depository System?**

  Physical share certificates are now converted to Electronic form. A depository holds securities (like shares, debentures, bonds, mutual fund units, etc.) of investors in electronic form (demat form) through a registered Depository Participant (DP). It provides services related to transactions in securities.

A DP is an agent of the depository through which it interfaces with the investor and provides depository services. It is now compulsory for every investor to open a beneficial owner (BO) account to apply in IPOs/FPOs or to trade in the stock exchange.

The advantages of availing depository services include:

- A safe and convenient way to hold securities
- Immediate transfer of securities
- No stamp duty on transfer of securities
- Elimination of risks associated with physical certificates such as bad delivery, fake securities, delays, thefts, etc.
- Reduction in paperwork involved in transfer of securities
- Reduction in transaction cost
- No odd lot problem, even one share can be traded
- Nomination facility
- Change in address recorded with DP gets registered with all companies in which investor holds securities electronically eliminating the need to correspond with each of them separately
- Transmission of securities is done by DP eliminating correspondence with companies
- Automatic credit into demat account of shares, arising out of bonus/split/merger, etc.
- Holding investments in equity and debt instruments in a single account.

**Rights as a Shareholder**

Shareholders need protection from malpractices and frauds. SEBI regulates the capital market. Its guidelines ensure rights of the shareholders are protected. For this purpose, it monitors all constituents of the capital market from issuers on one hand to stock exchanges on the other hand and all other intermediaries like stock brokers, merchant bankers and underwriters. More information on SEBI can be had from **www.sebi.gov.in.** The websites of the two national-level stock exchanges are as follows: **BSE - www.bseindia.com** and **NSE - www.nseindia.com.**

**Rights as a shareholder**

- To receive the shares on allotment or purchase within the stipulated time
- To receive copies of the Annual Report of the company
- To receive dividends, if declared, in due time
- To receive approved corporate benefits like rights, bonus, etc.
- To receive offer in case of takeover, delisting or buyback
- To participate/vote in general meetings
- To inspect the statutory registers at the registered office of the company
- To inspect the minute books of the general meetings and receive copies
- To complain and seek redressal against fraudulent and investor unfriendly companies
- To proceed against the company, if in default, by way of civil or criminal proceedings
- To receive the residual proceeds in case of winding up

**Portfolio**

Portfolio is the name given to the stocks you own. Such portfolio should consist of a maximum of 10 stocks at any given time. It is important to sell loss making stocks when they are 10% down from the purchase price, this will indeed result in selling many number of stocks in ones portfolio, given that it is always advised to buy stocks for a longer period of time, still it is better to sell them to ensure losses do not eat into profit making stocks. It is also equally important to add stocks that have a potential to grow.

While diversification mantra is heard far aloud, especially while investing in stocks, it is important to hit a balanced approach, whether it is sensible to invest ₹ 100 crores in 10 stocks or 1 lakh in 20 stocks has to be a well-thought out decision to be taken by the investor. It is obvious that a person having ₹ 1 lakh and investing in 20 stocks just has too many of them, as the market rises or falls each of them exhibits a different behavior; hence it is always wise to stick to the 10 rule as far as stocks are concerned.

*The following are the various types of shares:*

- *Blue Chips:* Blue chip shares are those of a company, which are financially strong, and of a high quality. For those of you who want a safe, low-risk, long-term investment, investing in these shares would be a safe bet. These provide dependable, modest returns at low risk. These companies have an excellent track record in dividend payments as well as of growth in earnings.
- *Growth stocks:* These are stocks in companies that have a fast growth rate like high-tech industries. These stocks pay low or no dividends as the returns are ploughed back for future expansions. These are a safe bet for those who do not need their money right away. These stocks tend to fluctuate more.
- *Income Stocks:* These shares are issued by companies having higher dividends. This is the right choice for you, if what you are looking for is high current income. These are stocks of stable industries and therefore less risky. Regular cash flow and stability characterise these stocks.
- *Cyclical stocks:* These are speculative stocks where the prices fluctuate with changes in the economy. These stocks are for those who are willing to take risks and are financially in a strong position.
- *Defensive stocks:* These stocks are safe and consistent securities in companies not affected by changes in an economy. As these are relatively low risk, the returns fetched are also low. These stocks are an ideal choice for older people who would like to avoid taking risks.
- *Speculative stocks:* These are high profit high-risk investments and are definitely not for the chicken hearted. These are for the professional investors. These are issued by companies that do not have an established track record.

*Tax Benefits*

- Profits arising on sale of any capital assets are treated as long-term if the same have been held for 36 months or more on the date of sale.
- In case of shares in a Company, the holding period requirement is 12 months or more in order to make long-

term capital gains. It is applicable for both Indian and Foreign Companies, Private and Public companies.

- In case of sale of equity shares listed on Stock Exchanges in India or the Indian Stock Exchanges and sold through a stock-broker the long-term Capital Gains so arising are fully exempt from income tax. The exemption is available only in respect of equity shares listed on Indian Stock Exchange whether it is an Indian Company or a foreign company. The shares sold outside the stock exchange platform or cases where the shares have been tendered under buyback scheme or under any open offer do not enjoy this exemption.
- It is important that the equity shares should be sold on the platform of stock exchange in India on which Security Transaction Tax (STT) has been paid. All equity share transactions executed on stock exchange are liable for STT.
- No exemption for long-term capital gains on shares sold on any stock exchanges outside India.
- Short-term capital gains on sale of equity shares sold on stock exchanges in India (held for less than 12 months) taxed at a flat rate of 15%.
- Where your other income excluding this short-term capital gains is less than basic exemption limit, you will be entitled to take the benefit of such shortfall in the basic exemption limit while calculating the tax liability.
- In case of shares other than equity shares whose sale take place on the platform other than Indian Stock Exchange covering transaction of unlisted shares as well as transactions of listed shares in the form of open offer or buy back by of these shares by the company directly. Any capital gains arising on sale of such transactions will still be treated as long-term if the shares have been held for 12 months or more on the date of sale. In case the shares are sold within 12 months, the short-term capital gains arising on such transaction shall be included in your regular income and shall be taxed at the slab rate applicable to you.
- The tax-rate applicable in case of long-term capital gains is 20% on the indexed capital gains. However in case the long-term capital gains calculated with indexation is higher than 10% of unindexed capital gains, the liability on such long-term capital gains shall be restricted to 10% only in certain cases.

- The option of opting between 20% on indexed long-term capital gains or 10% of unindexed capital gains is available only in case of listed shares which are transacted outside stock exchange.
- Where the shares sold are not listed in India, choosing between 10% unindexed and 20% indexed capital gains is not available.

*Other benefits:*

- *Capital Appreciation:* Equity shares of good companies appreciate in value and thus act as a partial hedge against inflation.
- *Bonus shares:* Successful companies issue bonus shares from time to time subject to the guidelines issued by the SEBI. After bonus shares are issued, shareholders are entitled to dividends not only on the original shares but also on the equity shares.
- *Annual dividends:* All reasonably profitable companies try to maintain a steady rate of dividends and some declare interim dividends as well.
- *Rights shares:* When a company desires to issue new equity shares the new shares must first be offered to the existing shareholders on a *pro rata* basis unless they agree to give up this right. Such shares are called rights shares. If the shareholder does not desire to subscribe to such shares they can sell them at a profit, provided there is a demand for them. Also, when such a rights offer is made, the rights coupons given enjoy a premium. Shareholders can renounce their right at a premium and get a profit.
- *Can be pledged as security:* Equity shares can be pledged as security to raise loans
- *Voting rights:* An equity shareholder enjoys voting rights in the general meetings of the company. He can also appoint a proxy to attend meetings on his behalf.

**Indian Depository Receipts**

**1. Whether a foreign company can access Indian securities market for raising funds?**

Yes, a foreign company can access Indian securities market for raising funds through issue of Indian Depository Receipts (IDRs)

**2. What is Indian Depository Receipts (IDRs)?**

An IDR is an instrument denominated in Indian Rupees in the form of a depository receipt created by a Domestic Depository (custodian of securities registered with the Securities and Exchange Board of India) against the underlying equity of issuing company to enable foreign companies to raise funds from the Indian securities markets.

**3. Which are all the legislations governing IDRs?**

Central Government notified the Companies (Issue of Indian Depository Receipts) Rules, 2004 (IDR Rules) pursuant to the section 605A of the Companies Act. SEBI issued guidelines for disclosure with respect to IDRs and notified the model listing agreement to be entered between exchange and the foreign issuer specifying continuous listing requirements.

**4. Who is eligible to issue IDRs?**

The eligibility criteria given under IDR Rules and Guidelines are as under:—

The foreign issuing company shall have:—

- pre-issue paid-up capital and free reserves of at least US$ 50 million and have a minimum average market capitalisation (during the last 3 years) in its parent country of at least US$ 100 million;
- a continuous trading record or history on a stock exchange in its parent country for at least three immediately preceding years;
- a track record of distributable profits for at least three out of immediately preceding five years;
- listed in its home country and not been prohibited to issue securities by any Regulatory Body and has a good track record with respect to compliance with securities market regulations.

The size of an IDR issue shall not be less than ₹ 50 crores.

**5. Which intermediaries are involved in issuance of IDRs?**

- Overseas Custodian Bank is a banking company which is established in a country outside India and has a place of business in India and acts as custodian for the equity shares of issuing company against which IDRs are proposed to be issued in the underlying equity shares of the issuer is deposited.

- Domestic Depository who is a custodian of securities registered with the as SEBI and authorised by the issuing company to issue Indian Depository Receipts;
- Merchant Banker registered with SEBI who is responsible for due diligence and through whom the draft prospectus for issuance of the IDR is filed with SEBI by the issuer company.

**6. Whether the draft prospectus for IDRs has to be filed with SEBI as in case of domestic issues?**

Yes. Foreign issuer is required to file the draft prospectus with SEBI. Any changes specified by SEBI shall be incorporated in the final prospectus to be filed with Registrar of Companies.

**7. Can IDRs can be converted into underlying equity shares?**

IDRs can be converted into underlying equity shares only after the expiry of one year from the date of the issue of the IDR, subject to the compliance of the related provisions of Foreign Exchange Management Act and Regulations issued thereunder by RBI in this regard.

**8. Has the draft prospectus for IDRs to be filed with SEBI as in case of domestic issues?**

On the receipt of dividend or other corporate action on the IDRs, the Domestic Depository shall distribute them to the IDR holders in proportion to their holdings of IDRs.

**9. Are there are any other requirements for investing in IDRs?**

Yes.

- IDRs can be purchased by any person who is resident in India as defined under FEMA.
- Minimum application amount in an IDR issue shall be ₹ 20,000.
- Investments by Indian companies in IDRs shall not exceed the investment limits, if any, prescribed for them under applicable laws

- In every issue of IDR—
  - (i) At least 50% of the IDRs issued shall be subscribed to by QIBs;
  - (ii) The balance 50% shall be available for subscription by non-institutional.

**10. Why do you need an IDR?**

An IDR is meant to diversify your holdings across regions to free you from a "region bias" or the risk of a portfolio getting too concentrated in the home market. You need to study the firm's financials before you buy its IDR. However, since these IDRs are listed, bought and sold on the Indian markets, the impact of global markets and exchange-rate risks are reduced, though not totally eliminated.

**11. How are IDRs taxed?**

IDRs are taxed differently from equity shares. If you sell an IDR within a year of purchase, your gains will be taxed at your income-tax rates. For exits made after a year, the tax rate will be 10% without indexation and 20% with indexation. Since the IDR does not deduct dividend distribution tax, dividends are taxed in your hand as per your income tax rates. IDRs also don't impose securities transaction tax.

**12. Is there a currency risk?**

In theory, the price of the underlying share of the international firm at the foreign exchange and the exchange rate would play a role in determining the price of the IDR on the domestic exchange. But, in practice, this may not play out fully because the IDR would need to be bought and sold in Indian rupees and its price discovery would happen based on demand and supply, just like any other equity share. Dividends declared by the firm will be distributed in foreign currency and this would be then converted to Indian rupees at prevailing exchange rates.

## Secondary Market

Secondary Market refers to a market where securities are traded after being initially offered to the public in the primary market and/ or listed on the Stock Exchange. Majority of the trading is done in the secondary market. Secondary market comprises equity markets and debt markets.

For the general investor, the secondary market provides an efficient platform for trading of his securities. For the management of the company, Secondary equity markets serve as a monitoring and control conduit—by facilitating value-enhancing control activities, enabling implementation of incentive-based management contracts, and aggregating information (via price discovery) that guides management decisions.

**Difference between the primary market and the secondary market**

In the primary market, securities are offered to public for subscription for the purpose of raising capital or fund. Secondary market is an equity trading avenue in which already existing/pre-issued securities are traded amongst investors. Secondary market could be either auction or dealer market. Stock exchange is the part of an auction market.

**The Process of Trading**

The normal course of online trading in the Indian market context is placed below:

Step 1. Investor/trader decides to trade

Step 2. Places order with a broker to buy/sell the required quantity of respective securities

Step 3. Best priced order matches based on price-time priority

Step 4. Order execution is electronically communicated to the broker's terminal

Step 5. Trade confirmation slip issued to the investor/trader by the broker

Step 6. Within 24 hours of trade execution, contract note is issued to the investor/trader by the broker

Step 7. Pay-in of funds and securities before T+2 day

Step 8. Pay-out of funds and securities on T+2 day

In case of short or bad delivery of funds/securities, the exchange orders for an auction to settle the delivery. If the shares could not be bought in the auction, the transaction is closed out as per SEBI guidelines.

### What is BSE Indo *Next*?

Regional stock exchanges (RSEs) have registered negligible business during the last few years and thus small and medium-sized companies (SMEs) listed there find it difficult to raise fresh resources in the absence of price discovery of their securities in the secondary market. As a result, investors also do not find exit opportunity in case of such companies.

BSE Indo Next has been formed to benefit such small and medium sized companies (SMEs), the investors in these companies and capital markets at large. It has been set up as a separate trading platform under the present BSE Online Trading (BOLT) system of the BSE. It is a joint initiative of BSE and the Federation of Indian Stock Exchanges (FISE).

### Equity Derivatives

An equity derivative is a class of derivatives whose value is at least partly derived from one or more underlying equity securities. Options and futures are by far the most common equity derivatives; however there are many other types of equity derivatives that are actively traded.

In India, around 98% of equity derivatives are traded on the National Stock Exchange.

### Equity Derivatives on BSE

Currently, BSE Sensex Futures and Sensex Options are actively traded on the BSE. BSE also allows futures trading in some 84 selected scrips. BSE is planning to add 135 additional stocks to this segment soon

### Equity Derivatives on NSE

The National Stock Exchange of India Limited (NSE) commenced trading in derivatives with the launch of index futures on June 12, 2000. The futures contracts are based on the popular benchmark S&P CNX Nifty Index.

### Standard & Poor's 500 (S&P 500)

Standard & Poor's 500 (S&P 500)index represents 500 leading companies of the U.S. economy and covers approximately 75% of U.S. equities. S&P 500 is maintained by S&P Indices and was introduced in 1957.

### Dow Jones Industrial Averages

Dow Jones Industrial Average index includes 30 large and liquid blue-chip stocks traded on U.S. exchanges. The index was first published in 1896 and represents leading companies selected from a diversified range of U.S. industries.

### Online Trading

Online trading in securities refers to the facility of investor being able to place his own orders using the internet trading platform offered by the trading member viz., the broker. The orders so placed by the investor using internet would be routed through the trading member.

Many of the big and medium sized trading members offer internet trading facility. Investor can get the details of trading members of the Exchange on the website www.nseindia.com. Identify brokers offering internet trading facility; check their references from persons having knowledge about financial markets and select a broker who has good reputation and capability to deliver all the services that are expected by the investor. Particular attention should be paid by the investor to the availability of support in case of technical problems while choosing the broker.

As per SEBI and Exchange stipulations, in addition to execution of regular KYC documents, the investor would have to execute a specific Member- client agreement for internet trading which broadly spells out the rights and obligations of trading member and Investor besides alerting on system related risk, confidentiality of user ID and password. Further, Member and investor may also agree amongst themselves in execution of other documents like Power of Attorney for DP operations, Opening of DP and bank account etc.

### Precautions an online investor must take before starting online trading

Investor has to take care that:

1. The Default password provided by the broker is changed before placing of order. Ensure that password is not shared with others. Change password at periodic interval.
2. The depositor has understood the manner in which the online trading software has to be operated.
3. The depositor has received adequate training on usage of software
4. The system has facility for order and trade confirmation after placing the orders.

**Securities Lending and Borrowing Scheme**

Under the securities lending and borrowing scheme, an owner of securities can lend the same to a borrower through an approved intermediary that acts as a central counterparty. An approved intermediary has to be registered with the Indian stock market regulator—the Securities and Exchange Board of India, or SEBI. There is no direct contact between the borrower and lender, and both the borrower and lender of securities independently enter into a contract with the approved intermediary.

The SLB scheme is facilitated by the National Securities Clearing Corporation of India (NSCCL), the clearing corporation of the National Stock Exchange of India (NSE), through a screen based exchange-traded system called SLB-NEAT. It has a centralised anonymous order book and all the borrowing and lending are cleared, settled and guaranteed. The expected lending fee is quoted as price and the tenures are available up to 12 months.

**Short-Term Strategies**

Investment is a long-term game and short-term trading is not considered a good strategy altogether for goal based financial planning. However, when considered from the viewpoint of traders and speculators, it would be wrong to suggest that short-term trading is bad. Investors should understand that short-term trading mostly relies on deep study (to a large extent, technical analysis), controlling one's emotions and surely luck.

In the current volatile market scenario, you could be tempted to try your luck in some short-term investment strategies to make the best out of a bad situation. Here is an understanding of some short-term trading strategies usually followed by short-term traders. Knowing these strategies will make you aware of your own actions. However, do proceed with caution.

***a. Regular Day-trade in stocks***

The traders buy and sell the stocks on the same day or in a very short period of time. The traders take advantage of daily market volatility to profit. They buy when the stock prices go down hoping the prices to appreciate in the day. They square-off by the end of the day. This can result in profit or loss depending on whether the price they sold at was higher or lower than their buy price. Even if traders lose money, the loss doesn't seem big as daily variation is not very volatile. Day-trading, however, is the most popular way to lose money.

Investors look at daily loss and assume that this is not a big loss but, accumulated losses over the year give a very different picture. Investors should not put all their money in day-trading. If you are too excited by daily price volatility and want to try your hands in day-trading, put aside at the most 10% of your total investment for this and play with this.

**b. *The Concept of Trading on Margin***

In margin trading, the investor spends some part from his or her pocket and borrows the rest from the broker at an interest. In this context, investors have to understand the concept of initial and maintenance margin. Initial margin is the % of total investment that investors have to put. When the prices go down, your contribution in terms of percentage will go down. After it goes below a certain percentage, the broker will ask you to put more money to take it to the initial margin. This "certain percentage" is called maintenance margin.

An investor, Rakesh buys 100 stock of Airtel at ₹ 400 a share. The initial margin is 25% and maintenance margin is 10%. This means Rakesh has to put ₹ 10,000 (25% of total investment of ₹ 40,000). The remaining ₹ 30,000 is borrowed by broker. Suppose the prices start going down and go to ₹ 330 a share. In this case, the total value is 330x100 = ₹ 33,000. Let's calculate what the contribution by investor at this point is. The investor contribution is (33,000-30,000)/33,000. This is less than 10%. Hence investor will get a call to put more money so that his or her contribution is 25% of ₹ 33,000 which is ₹ 8,250. Since his amount is ₹ 3,000, he will have to deposit another ₹ 5,250.

This is high risk high-return strategy. The advantage is that if the prices go up, you earn all the profit minus the interest you pay to the broker on his contribution. However, the loss is equally yours because the broker will anyway charge the interest.

**c. *The Selling Short - Speculative Concept***

In this short-term strategy, investors borrow and sell the shares and later they have to buy this from open market and give it back to the lender. The idea is to benefit from decreasing prices. Investors short-sell stocks because they assume that prices will go down and when it goes down they buy it cheaper and give it back. The difference is the profit to investors.

An investor Rakesh expects the price of Airtel with current market price @400 to go down. Since he has no stocks, he borrows 100 Airtel stocks from the market and sells it immediately earning ₹ 40,000. After sometime, as he expected, the Airtel price went down to 350. He buys 100 stocks back at ₹ 35,000 and gives it back. He earns ₹ 5,000 from this transaction. We are ignoring transaction costs and other charges for the sake of simplicity.

*Risk mitigation*

Short-selling is speculative in nature and investors may lose if the prices go up. There is no guarantee that stocks will go down as expected. If you are keen on doing it, use a very small amount (less than 10% of your investment) for short-selling.

There are short-term investors who have done tremendously well but they are few and far between. Hence investors should put their major portion of investment corpus for long-term wealth building assets and segregate a minor portion for short-term speculation.

**Choosing between Stock or Mutual Funds**

The two methods of investing in equities are either directly or indirectly. Direct investment entails purchasing stocks directly, while indirect investment entails investing in mutual funds that in turn invest in stocks.

*Differences in investing in stocks vs mutual funds:*

There are many differences between investing in stocks and mutual funds. Here are the major differences between them.

| S. No | Stocks | Mutual funds |
|---|---|---|
| 1 | Need a demat account for buying and selling | No need for demat account, except for buying and selling ETFs |
| 2 | Must be traded through a broker except in case of IPO | Can be traded through a financial broker or directly by approaching the fund house |
| 3 | A part owner of the company, making you eligible for bonus shares, voting rights, etc. | You don’t own shares directly, so you are not eligible for any rights due to the owner |

| S. No | Stocks | Mutual funds |
|---|---|---|
| 4 | Get dividend if the company makes the profit | Dividend is optional and if chosen will affect the value of your investment by the amount of dividend declared |
| 5 | Keep a check on the performance of your holdings | Expert fund managers take care of all the activities |
| 6 | The charges incurred here are the demat charges, and buying/selling charges (only when the transaction takes place) | There is an entry load, exit load, fund management charges and buy sell spread. These charges can significantly affect the returns generated by the fund |
| 7 | Price of a share can be very volatile | Normally the NAVs do not show a significant rise or crash |
| 8 | Need a lot of money to diversify | Diversification can be achieved with amounts as low as ₹ 5,000 (or even lesser in case of ELSS) |

*Pros and cons of both the Types of investment:*

**Stocks:**

| S. No | Pros | Cons |
|---|---|---|
| 1 | Owner of the company | Higher risk since if the company closes down, you tend to lose money |
| 2 | Earn dividends, which may be your source of income | The fortunes of even the most profitable companies can change suddenly, so you stand to lose the dividend |
| 3 | Buy/sell in the stocks at the price of your choice by using the option of stop loss | Your stop loss may not be reached, making it difficult for you to trade in the stock |
| 4 | | Suitable only for experienced investors |
| 5 | | Is time consuming as you need to study the fundamentals of the stock |

| S. No | Pros | Cons |
|---|---|---|
| 6 | | Diversification needs a lot of money which is not possible for small investors |
| 7 | | May not be liquid, particularly if the company is small or mid-cap |

**Mutual funds:**

| S. No | Pros | Cons |
|---|---|---|
| 1 | Managed professionally | End up paying the charges for availing of this expertise |
| 2 | Diversification can be achieved with nominal amount of ₹ 5,000 | No say while deciding where your money is invested. The fund manager decides for you and he may be wrong, thus causing a loss |
| 3 | Very liquid | Have to pay exit load if you redeem your investment before a certain time frame |
| 4 | Can be purchased directly thus saving you from having to pay entry load | High fund management expenses can erode the returns |
| 5 | Unlike companies, mutual funds will not close down. Rather they would be merged into another successful fund | Tend to be mis-sold by the mutual fund advisors as well as fund houses |

While both mutual funds and stocks have their own distinct features, it is up to each individual investor to decide where to invest. For those who have time, expertise and money, direct investing can be done. For others, mutual funds are the way to go. In fact, some funds have managed to outperform their benchmark index. However one important point to be noted is that both are long-term investment options.

## THE STOCK MARKET BEHAVIOUR

### *Stock Market Psychology*

Some of the most common mistakes while investing are:

1. *Going with the Crowd*

   It is human nature to look to others to determine the best course of action for ourselves. If we see others buying stocks, then it must be a good time to buy. The same goes for when everyone else is selling. It's also known as Herd Mentality. It usually comes into play during a Bull Run or a Bear Run where everyone is buying or selling not because of some fundamental factors but because others are doing so.

2. *Scarcity*

   We all have a natural tendency to want things that are in short supply. The more rare an item, the greater becomes its value, because few will be able to possess it. Not only do we want a scarce item more, but we will make up reasons for why we want it so. As the market rises, stocks at lower prices become more and more scarce, which creates more buying, which makes them scarcer, and on and on it goes until the music stops.

3. *Loss aversion*

   When there is a large drop in the stock market and we have lost a lot of money, we are shy about buying more. Once we have lost, we want to hold on to what we have for fear of losing more. This makes us most likely to buy when prices are high, because we have lost nothing and have gained much (at least on paper). Similarly we are likely to sell or at the very least, not buy, when prices are low.

4. *Self-serving bias*

   Self-serving bias helps investors avoid accountability. Although you might feel better by following this bias, you will be cheating yourself out of a valuable opportunity to improve your investing intelligence. If you've never made a mistake in the market, you'll have no reason to develop better investing skills and your returns will reflect it.

5. *Past serves the future*

   When investors start believing that the past equals the future, they are acting as if there is no uncertainty in the market. Believing that the past predicts the future is a sign of overconfidence. When enough investors are overconfident, it pumps the market up to the point where a huge correction is inevitable.

6. *Anchoring*

It refers to focusing on one detail at the expense of all the others. Maybe we have read a good report on a particular stock in a magazine. Now, if the business news is reporting some flaws in corporate governance in the company which can have serious implications on the company's functionality, rather than selling it we would ignore the news and hold on to the stock because our mind is anchored to the magazine article.

### *(2) Even the Odds*

When we feel ourselves getting caught up in the emotion of the stock market, we must stop ourselves from buying or selling anything. Decisions that are made in haste are usually decisions that we will regret later on.

This is why many experts encourage investors to have a strategy. When you are swept up by the powerful forces of scarcity, you can fall back on your strategy. Before making a stock trade, simply ask yourself this – Does this trade fit into my long-term stock trading strategy? If not, then you must walk away.

### *(3) Investment Methods to be Avoided*

Your investment style is an extension of your own personality. A calmer demeanour would most probably have a conservative approach to investing and would choose safer deposits over riskier returns. Their approach would be in stark contrast to the route adopted by the hyper lot who take risks hoping it results in higher returns. No matter which style of investing you choose for yourself, there are a few personality traits that are best kept away when managing your money. So, while it is very interesting to note the kind of investor that you are (or could be), it is probably more enlightening to realise the kind of investor that you should never turn into. Here are three types of investors that you should be wary of:

*The Hoarder*

He is so carried away with accumulating all possible investment avenues that he simply doesn't have the time to focus on reviewing his portfolio and is most often stuck with funds that he could do without. His portfolio would probably resemble a sort of supermarket of funds, complete with a section on new launches (NFOs) and cash-backs (Dividend paying funds). On the face of it, the Hoarder might seem like the eternal optimist, clinging on to a fund even when it has repeatedly disappointed over the years and the only real reason that the Hoarder stays with a poor performing fund is because he is too busy adding some more to his portfolio.

*The Bundle of Nerves*

The Bundle of Nerves is always looking for the slightest movement in the market to drive him into action, either to add a new fund or to let go of an old one. Keeping his portfolio constant is not his style. And, yes, he keeps his financial advisor on his speed dial.

He believes that "Change" (or rather Churn) is the key to having a successful portfolio. An avid follower of investment shows, stock market predictions and financial channels' minute-by-minute update, the Bundle of Nerves needs to see constant movement in his investments to feel at ease – either by increasing or reducing the number of his funds. The Bundle of Nerves lacks the most important skill in investing- Patience!

*The Sitting Duck*

The Sitting Duck is excited about investing, and he trusts blindly. Most first time investors believe that their financial advisor or investment guru will have an answer for absolutely everything related to investments. It takes them a while to understand that their advisor too is human, and that it is only human to err. It helps to note that the part in the discussion where the investor is asked for his views on the proposed "get-rich-quick" plan also offers scope for refusal. The Sitting Duck fails to see that a proposal proposes, and that he has the absolute right to dispose of it.

While every individual has different objectives, beliefs and level of knowledge, whatever type of investor you are, don't be a hoarder, a bundle of nerves or a sitting duck.

## GOLD

Gold has traditionally been extremely popular with Indians. Almost every household possesses gold in one form or the other and it forms part of important events like marriage, religious ceremonies, etc. It is also an important asset class, used as a currency and a commodity.

### 1. Major Characteristics

- Gold (Chemical Symbol—Au) is primarily a monetary asset and partly a commodity.
- Gold is the world's oldest international currency.

- Gold is an important element of global monetary reserves.
- With regards to investment value, more than two-thirds of gold's total accumulated holdings is with central banks' reserves, private players, and held in the form of high-carat jewellery.

  Less than one-third of gold's total accumulated holdings are used as "commodity" for jewellery in the western markets and industry.

**2. Demand and Supply Scenario**

- Gold demand in 2010 reached a 10-year high of 3,812.2 tonnes, worth US$ 150 billon, as a result of:
  - o strong growth in jewellery demand;
  - o the revival of the Indian market;
  - o strong momentum in Chinese gold demand and
  - o a paradigm shift in the official sector, where central banks became net purchasers of gold for the first time in 21 years.
- China was the world's largest gold producer with 340.88 tonnes in 2010, followed by the United States and South Africa. In March 2012, China still remains the largest supplier of gold.

**3. Global Scenario**

- London is the world's biggest clearing house.
- Mumbai is under India's liberalised gold regime.
- New York is the home of gold futures trading.
- Zurich is a physical turntable.
- Istanbul, Dubai, Singapore, and Hong Kong are doorways to important consuming regions.
- Tokyo is where TOCOM sets the mood of Japan.

**4. Indian Scenario**

- India is the largest market for gold jewellery in the world. 2010 was a record year for Indian jewellery demand; at 745.7 tonnes, annual demand was 13% above the previous peak in 1998. In local currency terms, Indian jewellery demand more than doubled in 2010. For 12 months ended Q1 2012, the jewellery demand stood 534 tonnes.

- The total consumer demand in India stood at US$ 44,920 million for 12 months ended Q 1 2012.
- The budget for 2012 caused a lot of disruption to the gold market causing a national strike among jewellers. Weakness and volatility in the rupee gold price added to the consumers' reluctance to increase their volume purchases of gold. The second quarter of 2012 is likely to see something of a normalization of investment demand as consumers adjust to higher import taxes and bullion dealers rebuild their stock.

**5. Factors Influencing the Market**

- Above ground supply of gold from central bank's sale, reclaimed scrap, and official gold loans.
- Hedging interest of producers/miners.
- World macroeconomic factors such as the US Dollar and interest rate, and economic events.
- Commodity-specific events such as the construction of new production facilities or processes, unexpected mine or plant closures, or industry restructuring, all affect metal prices.
- In India, gold demand is also determined to a large extent by its price level and volatility.

**Advantages of Investing in Gold**

- Diversification
- Low Liquidity Risk
- Hedge against Inflation
- Good Returns
- Low Credit Risk
- Safe Haven Investment
- Avenues of Investment
    - Jewellery
    - Gold Coins
    - Gold Bars

- ETF
- Global Mutual Fund
- Gold Fund of Fund
- Gold Derivatives (Futures) through MCX
- E-Gold
- Gold Accumulation Schemes/Savings for Gold Scheme
- Gold Deposit Scheme

**No Loan Against Gold**

- RBI bars banks from lending against gold Exchange Traded Funds (ETFs) to further curb gold imports.
- NBFCs are not allowed to lend against gold in any form.

**Invest in Gold**

Gold is considered as an investment option, and has now become a part of portfolio of many investors and hedge funds.

***(1) Diversification***

As we all know, diversification is an important aspect of an investment strategy as it allows an investor to maintain the right balance between asset classes of different correlations. However, many of us rely mainly on equities and debt instruments alone to achieve diversification in our portfolios. Though we Indians always fancy owning gold for various cultural and emotional reasons, not many of us consider it to be a part of the portfolio while deciding on the asset allocation. The truth, however, is that gold can be an integral part of the portfolio as it has a negative correlation with the other preferred asset classes such as equities and debt. Ideally you should invest in gold ETFs once you have a well diversified portfolio of funds and restrict exposure to gold by allocating not more than 5-10 per cent of your total investments.

***(2) Low liquidity risk***

A wide range of buyers like the jewellery sector, financial institutions, manufacturers of industrial products as well as various investment channels including coins and bars, futures and options as well as gold ETFs (Exchange Traded Funds) make liquidity risk very low.

***(3) Hedge against inflation***

The often-heard term 'inflation' is the rate at which prices of goods and services rise. It eats away the future purchasing power of the wealth you create painstakingly through meticulous investments. If you find it difficult to meet your monthly expenditure, blame it on the inflation monster.

Gold enjoys the reputation of being the protector of wealth against this monster. In other words, gold has the potential to maintain its purchasing power over the longer term through both inflationary and deflationary periods. The inflation-adjusted returns from gold have been spectacular over the last few years.

***(4) Good returns***

Besides, gold also has the potential to provide impressive returns over a sustained buoyant period, as is currently the case.

***(5) Low credit risk***

The new investment avenues like Gold ETF, Gold Funds and E-gold provide a safe opportunity to invest in gold since it's guaranteed by the Exchange (NSE, Spot exchange or the respective mutual fund) and the underlying gold is also adequately insured.

***(6) Safe haven investment***

Gold is considered as an all-weather investment and as a currency in itself. In times of war, financial markets uncertainty, geo-political tensions, gold provides a good hedge and remains strong during such turbulent times.

Gold is pegged to the US dollar and has an inverse relationship with the dollar. In the event of a financial or economic turmoil in the US, the dollar could weaken against many other currencies, sending the gold price upwards. Political turmoil across the globe could send the gold price upwards too.

**7. Avenues Available to Invest in Gold**

***(1) Jewellery***

Indians invest in jewellery for multiple reasons. They can use it for marriage, wear for parties, and get it liquidated when in crisis. Moreover, accumulating jewellery is a sort of tradition and hence many families still find it the best way to invest.

| Pros | Cons |
|---|---|
| Investment is very easy. You only need cash to invest<br>If you invest early it saves you a significant expense at the time of marriage | You own it in physical form, so threat of theft<br>Making charges offset the profit in terms of price appreciation (varies from 10% to 35% at times)<br>Normally it's a virtual investment as people don't want to sell it |

**(2) *Gold Coins***

Since most of the gold coins are sold by banks, the purity is guaranteed unlike jewellery where you have to rely on your jeweller. Investors who do not want to take any chance but still want to invest in physical gold go for gold coins.

Recently, India Post has introduced gold coins with India Post logo for sale to the customers across India. The gold coins are of the denomination 0.5 g, 1 g, 5 g and 8 g of 24 carat with 99.99% purity. The gold coins are manufactured by Valcambi, Switzerland and have the benefits of internationally recognised certification, quality packaging, and product standardisation and assayer certificate. This facility is available in 630 Post Offices across India.

| Pros | Cons |
|---|---|
| Value is quite comparable to international gold price<br>One of the most recognised and reliable way to invest in gold<br>Investment is very easy. You can buy it from banks, local shops, etc.<br>Big investment is not required to take exposure as it's available in smaller denominations | You own it in physical form, so threat of theft.<br>You pay a premium of 4% to 10% while buying and same % is discounted while selling resulting in lesser overall return |

| Pros | Cons |
|---|---|
| Easy to store | |
| Very liquid | |

### (3) *Gold Bars*

If you are comfortable with storage and large initial investment amount, this can be one of the best options as loss in terms of premium/discount is the least.

Issues of fake purchases can be taken care if you buy from an authentic source.

| Pros | Cons |
|---|---|
| Value is quite comparable to international gold price | You own it in physical form, so threat of theft. |
| Premium/discount paid while purchasing and selling is the least | Initial investment can be large as smaller denominations are not available. |
| Most recognised and reliable way to invest in gold | Increased risk of forgery. |
| Investment is very easy. You can buy it from banks, local shops, etc. | Storage cost for large bars. |
| Quite liquid | |

### (4) *ETF*

Gold ETFs are units representing physical gold, which may be in paper or dematerialized form. These units are traded on the exchange like a single stock of any company. Gold ETFs are intended to offer investors a means of participating in the gold bullion market without the necessity of taking physical delivery of gold, and to buy and sell that participation through the trading of a security on the stock exchange. The charges applicable are just the brokerage charges applicable for other stocks from your broker.

You will need a demat account to buy gold ETFs. Since Gold ETFs invest directly in physical gold which means the buying and selling price of all the gold ETFs is identical. The returns generated by gold ETFs at any given point of time are also similar though there will be a minuscule difference between the schemes because of their different expense ratios. So, look for the ETF with the least expense ratio to invest in.

**Can gold be used as collaterals or margins?**

Gold ETF can be considered as collaterals or margins. Most of the financial institutions accept gold as collaterals or margin with some hair cut applicable.

**Who guarantees the purity bought?**

The authorised custodian (safe keeper) sources gold from LBMA (London Bullion Market Association) approved refiners on behalf of investors. The amount of physical gold held by the custodians in all schemes is of fineness (purity) of 99 parts per 1000. In other words, this gold is 99.5 per cent pure. This purity is also called a 24 carat gold in general parlance. What's more the gold held with the custodian is fully insured.

**FIXED INCOME**

Fixed-income securities are investments where the cash flows are according to a pre-determined amount of interest, paid on a fixed schedule. The different types of fixed income securities include government securities, corporate bonds, commercial paper, treasury bills, strips, etc. The investors benefit by investing in fixed income securities as they preserve and increase their invested capital or also ensure the receipt of dependable interest income. The instruments traded can be classified into the following segments based on the characteristics of the identity of the issuer of these securities:

| | | |
|---|---|---|
| **Government Securities** | Central Government | Zero Coupon Bonds<br>Coupon Bearing Bonds,<br>Treasury Bills<br>STRIPS |
| | State Governments | Coupon Bearing Bonds |
| **Public Sector Bonds** | Government Agencies/Statutory Bodies | Government Guaranteed Bonds, Debentures |
| | Public Sector Units | PSU Bonds<br>Debentures<br>Commercial Paper |

| | | |
|---|---|---|
| **Private Sector Bonds** | Corporates | Debentures,<br>Bonds,<br>Commercial Paper, Floating Rate Bonds, Zero Coupon Bonds, Inter-Corporate<br>Deposits |
| | Banks | Certificates of Deposits, Debentures, Bonds |
| | Financial Institutions | Certificates of Deposits, Bonds |

**Government Securities**

**Government of India Dated Securities**

G-Secs or Government of India dated Securities are Rupees One hundred face-value units/debt paper issued by Government of India in lieu of their borrowing from the market. These form a part of the borrowing program approved by the parliament in the 'union budget'. These can be referred to as certificates issued by Government of India through the Reserve Bank acknowledging receipt of money in the form of debt, bearing a fixed interest rate (or otherwise) with interests payable semi-annually or otherwise and principal as per schedule, normally on due date on redemption.

G- Secs are normally issued in dematerialized form (SGL). When issued in the physical form they are issued in the multiples of ` 10,000. Normally the dated Government Securities, have a period of 1 year to 20 years. Government Securities when issued in physical form are normally issued in the form of Stock Certificates. Such Government Securities when desired to be traded in the physical form are delivered by the transferor to transferee along with a special transfer form designed under Public Debt Act 1944.

The transfer does not require stamp duty. The G-Secs cannot be subjected to lien. Hence, is not an acceptable security for lending against. Some Securities issued by Reserve Bank of India like 8.5% Relief Bonds are securities specially notified & can be accepted as Security for a loan.

**New G-Secs issued by Government of India**

*Inflation linked bonds:* These are bonds for which the coupon payment in a particular period is linked to the inflation rate at that time the base coupon rate is fixed with the inflation rate (consumer price index–CPI) being added to it to arrive at the total coupon rate.

The idea behind these bonds is to make them attractive to investors by removing the uncertainty of future inflation rates, thereby maintaining the real value of their invested capital.

FRBs or Floating Rate Bonds comes with a coupon floater, which is usually a margin over and above a benchmark rate. E.g., the Floating Bond may be nomenclature/denominated as +1.25% FRB YYYY (the maturity year). +1.25% coupon will be over and above a benchmark rate, where the benchmark rate may be a six month average of the implicit cut-off yields of 364-day Treasury bill auctions. If this average works out 9.50% p.a. then the coupon will be established at 9.50% + 1.25% i.e., 10.75% p.a. Normally FRBs (floaters) also bear a floor and cap on interest rates. Interest so determined is intimated in advance before such coupon payment which is normally, semi-annual.

*Zero coupon bonds:* These are bonds for which there is no coupon payment. They are issued at a discount to face value with the discount providing the implicit interest payment. In effect, zero coupon bonds are like long duration T-Bills.

**State Government Securities/State Devt. Loans/State Bonds**

These are issued by the respective state governments but the RBI coordinates the actual process of selling these securities. Each state is allowed to issue securities up to a certain limit each year. The Planning Commission, in consultation with the respective state governments, determines this limit. Generally, the coupon rates on state loans are marginally higher than those of GOI-Secs issued at the same time.

The procedure for selling of State loans, the auction process and allotment procedure is similar to that for GOI-Sec. State Loans also qualify for SLR status Interest payment and other modalities are similar to GOI-Secs. They are also issued in dematerialised form.

SGL Form State Government Securities are also issued in the physical form (in the form of Stock Certificate) and are transferable. No stamp duty is payable on transfer for State Loans as in the case of GOI-Secs. In general, State loans are much less liquid than GOI-Secs.

**Government of India 8% Savings Bonds**

The Government of India 8 per cent Savings Bonds, 2003 (taxable) scheme is another instrument suitable for investors seeking returns that are fixed and assured. GOI Savings Bonds may not be terrific investment option if you are looking for capital appreciation or a substantial margin over inflation.

Further, investments in RBI's 8% Savings Bonds do not qualify for Income Tax Deductions and interest earned is fully taxable. However, unlike other saving instruments, they are risk-free.

**Who can invest?**

A. An individual

(a) Who is not a Non-resident Indian

(b) In his or her individual capacity or

(c) On joint basis, or

(d) Anyone or survivor basis, or

(e) On behalf of a minor as father/mother/legal guardian.

B. A Hindu Undivided Family

C. An Institution

1. 'Charitable Insititution' under section 25 of the Indian Companies Act, 1956.
2. Institution obtained Certificate of Registration as charitable institution.
3. Any Institution which obtained certificate from Income Tax Authority u/s 80G of Income-tax Act, 1961.

"UNIVERSITY" established or incorporated by Central, State or Provincial Act, u/s 3 of University Grants Commission Act, 1956 (3 of 1956).

**Mode of Holding**

Bonds are issued in the form of Bond Ledger Account in denominations of ₹ 1,000. These bonds are not transferable. A nomination facility is available.

**Liquidity**

These bonds cannot be traded in secondary market. The good thing is that investors can get a loan against these bonds, from select banks.

**Salient Features**

- *Minimum Contribution:* ₹ 1,000 (Investment in multiples of 1,000); no maximum limit on investment
- *Maturity Period:* The tenure of the bond is 6 years from the date of issue. No interest would accrue after the maturity of the bond.

- *Options Available :* (1) Half Yearly Interest Payable, (2) Cumulative
- *Rate of Interest:* Bonds will bear interest @ 8.00% p.a. and are payable half-yearly. The interest payment dates are February 1 and August 1 for non-cumulative investments. For investors who have chosen the cumulative option, the value of the investments at the end of 6 years would be ₹ 1,601 (being Principal and Interest) for every ₹ 1,000 invested. Interest on the Bonds is taxable under Income Tax Act 1961.
- *Compounding Frequency :* Half Yearly Compounding for Cumulative
- *Premature Withdrawal :* Not allowed
- *Nomination Facility :* Nomination facility is available for Individual investment for sole holder or surviving holder basis. This facility is not available for joint holdings and minor investment.
- *Tax Exemptions :* No income tax exemption available; however, the bonds will be exempt from Wealth-Tax under the Wealth-Tax Act, 1957
- *Tax on Interest:* Fully Taxable

## CORPORATE FIXED INCOME SECURITIES

### Debenture

A Debenture is a debt security issued by a company (called the Issuer), which offers to pay interest in lieu of the money borrowed for a certain period. In essence it represents a loan taken by the issuer who pays an agreed rate of interest during the lifetime of the instrument and repays the principal normally, unless otherwise agreed, on maturity.

Debentures are long-term debt instruments issued by private sector companies. These are issued in denominations as low as Rs.1000 and have maturity ranging between one and ten years. Long maturity debentures are rarely issued, as investors are not comfortable with such maturity.

Debentures enable investors to reap the dual benefits of adequate security and good returns. Unlike other fixed -income instruments such as Fixed Deposits, Bank Deposits they can be transferred from one party to another by using transfer from. Debentures are normally issued in physical form. However, corporate/PSUs have started issuing debentures in Demat form. Generally, debentures are less liquid as compared to PSU bonds and their liquidity is inversely proportional to the residual maturity. Debentures can be secured or unsecured.

Debentures are divided into different categories on the basis of:

(1) Convertibility of the instrument

(2) Security

Debentures can be classified on the basis of convertibility into:

- *Non Convertible Debentures (NCD):* These instruments retain the debt character and cannot be converted into equity shares
- *Partly Convertible Debentures (PCD):* A part of these instruments are converted into Equity shares in the future at notice of the issuer. The issuer decides the ratio for conversion. This is normally decided at the time of subscription.
- *Fully convertible Debentures (FCD):* These are fully convertible into equity shares at the issuer's notice. The ratio of conversion is decided by the issuer. Upon conversion the investors enjoy the same status as ordinary shareholders of the company.
- *Optionally Convertible Debentures (OCD):* The investor has the option to either convert these debentures into shares at the price decided by the issuer/agreed upon at the time of issue.

On basis of Security, debentures are classified into:

- *Secured Debentures:* These instruments are secured by a charge on the fixed assets of the issuer company. So if the issuer fails to pay either the principal or interest amount, his assets can be sold to repay the liability to the investors.
- Unsecured Debentures: These instruments are unsecured in the sense that if the issuer defaults on payment of the interest or principal amount, the investor has to be along with other unsecured creditors of the company.

**Rights as a debenture holder**

- To receive interest/redemption in the stipulated time
- To receive a copy of the trust deed on request

- To apply before the CLB in case of default in redemption of debentures on the date of maturity
- To apply for winding up of the company if the company fails to pay its debt
- To approach the Debenture Trustee for grievances

## BONDS AND DEBENTURES

Long-term debt securities issued by the Government of India or any of the State Governments or undertakings owned by them or by development financial institutions are called as bonds. Instruments issued by other entities are called debentures. The difference between the two is actually a function of where they are registered and pay stamp duty and how they trade.

Debenture stamp duty is a state subject and the duty varies from state to state. There are two kinds of stamp duties levied on debentures viz. issuance and transfer. Issuance stamp duty is paid in the state where the principal mortgage deed is registered. Over the years, issuance stamp duties have been coming down. Stamp duty on transfer is paid to the state in which the registered office of the company is located. Transfer stamp duty remains high in many states and is probably the biggest deterrent for trading in debentures in physical segment, resulting in lack of liquidity.

On issuance, stamp duty is linked to mortgage creation. Wherever applicable while on transfer, it is levied in accordance with the laws of the state in which the registered office of the company in question is located. A debenture transfer has to be effected through a transfer form prescribed for under Companies Act.

Issuance of stamp duty on bonds is under Indian Stamp Act 1899 (Central Act). A bond is transferable by endorsement and delivery without payment of any transfer stamp duty.

### Deep Discount Bonds

A bond that sells at a significant discount from par value and has no coupon rate or lower coupon rate than the prevailing rates of fixed-income securities with a similar risk profile is called a **Deep Discount Bond**.

These bonds are designed to meet the long- term funds requirements of the issuer and investors who are not looking for immediate return and can be sold with a long maturity of 25-30 years at a deep discount on the face value of debentures.

## PSU Bonds

These are Medium or long term debt instruments issued by Public Sector Undertakings (PSUs). The term usually denotes bonds issued by the central PSUs (ie PSUs funded by and under the administrative control of the Government of India). Most of the PSU Bonds are sold on Private Placement Basis to the targeted investors at Market Determined Interest Rates. Often, investment bankers are roped in as arrangers to this issue. Most of the PSU Bonds are transferable and have endorsement at delivery and are issued in the form of Usance Promissory Note.

In case of tax free bonds, such bonds are normally accompanied by post- dated interest cheques/warrants.

## Bonds of PFIs/AIFIs

Apart from public sector undertakings, Financial Institutions are also allowed to issue bonds. They issue bonds in 2 ways:—

(1) Through public issues targeted at retail investors and trusts

(2) Through private placements to large institutional investors

PFIs offer bonds with different features to meet the different needs of investors, e.g. Monthly return bonds, Quarterly coupon bearing Bonds, cumulative interest Bonds, step up bonds etc. Some PFIs are allowed to issue bonds (as per their respective Acts) in the form of Book entry; hence, PFIs like IDBI, EXIM Bank, NHB, do issue Bonds in physical form (in the form of holding certificate or debenture certificate as the case may be, in book entry form). PFIs who have provision to issue bond in the form of book entry are permitted under the Respective Acts to design a special transfer form to allow transfer of such securities. Nominal stamp duty/transfer fee is payable on transfer transactions.

## Infrastructure Bonds

### *Tax-saving infrastructure bonds*

These are special bonds issued by institutions such as Industrial Finance Corporation of India, Infrastructure Development Finance Corporation, and any non-banking financial company, also called infrastructure finance company by the Reserve Bank of India. In financial years 2010-11 and 2011-12, the likes of Larsen & Toubro, India Infrastructure Finance Company Limited, Power Finance Corporation and IDFC issued these in tranches.

### *Corporate Bonds*

Corporate Bonds are issued by public sector undertakings and private corporations for a wide range of tenors but normally up to 15 years. However, some banks and companies like Reliance have also issued Perpetual Bonds.

Compared to Government bonds, corporate bonds generally have a higher risk of default. This risk depends, of course, upon the particular corporation issuing the bond, its rating, the current market conditions and the sector in which the company is operating. Corporate bond holders are compensated for this risk by receiving a higher yield than government bonds. Some corporate bonds have an embedded call option that allows the issuer to redeem the debt before its maturity date. Some even carry a put-option for the benefit of the investors. Other bonds, known as convertible bonds, allow investors to convert the bond into equity.

### Company Deposits

When it comes to investments, all of us would like to earn higher and secured returns. If you also belong to the same category, corporate Fixed Deposits (FDs) present a good option in these times of high inflation and inflation FD rates. However, one needs to look at following aspects of corporate FDs to understand the characteristics and nature of returns to understand this investment instrument.

*Characteristics*

1. Corporate FDs usually earn higher interest rates as compared to bank FDs (can range from 9% to 16%).
2. Like bank FDs, they are good source of monthly, quarterly, half-yearly or yearly interest income.
3. The tenure is flexible, ranging from six months to seven years.
4. Also, there is no tax deduction at source for FDs earning interest of up to ₹ 5,000 a year.
5. Unlike bank FDs, corporate FDs give you an option to choose a nominee for your investment.
6. In addition, the operational process is hassle-free, resulting in easy opening of corporate accounts. In some cases, even PAN card is not allowed.
7. On the other hand, corporate FDs are not as secured as bank FDs as all the returns shown are projected and not guaranteed.

Companies accept Fixed Deposits from investors for short durations of 6 months to 3 years. While they are similar to bank fixed deposits, they offer less liquidity and usually carry higher risk and return. This results in mobilization of household savings for utilization in productive purposes by the corporate sector.

Features of Company Fixed Deposits are:

- Fixed deposit scheme offered by a company Are similar to a bank deposit
- Used by companies to borrow from small investors
- The investment period must be selected carefully as most FDs are not encashable prior to their maturity
- Not as safe as a bank deposit. Company deposits are 'unsecured'
- Offer higher returns than bank FDs, since they entail higher risks
- Ratings can be a guide to their safety

**Rights of deposit holders**

- Right to receive periodic interest payments on time.
- Right to receive intimation regarding any amendment to the terms of repayment of deposits.
- Right to receive the amount of matured deposits on time.
- Right to intimation regarding unclaimed deposits before transfer to the IEPF.
- Right to file complaint in the prescribed format before Company Law Board (in the office where the registered office of the company is situated) in case of default in repayment of deposits.
- Right to alternatively file complaint in the Consumer Forum under the Consumer Protection Act, 1986.

**Investing in company Fixed Deposits Schemes**

**DO's**

✓ Do check the credit rating assigned by the Credit Rating Agencies to the Fixed Deposits being considered

✓ Do ignore the unrated Fixed Deposit schemes

- ✓ Do understand the background and credibility of the promoters
- ✓ Do choose a company with a better track record for similar rated companies
- ✓ Do avoid investing in Fixed Deposits of companies whose promoters have a dubious record
- ✓ Do realise while investing in Fixed Deposits that if the company is unable to repay your money, you may end up losing it, as Deposits are unsecured
- ✓ Do refer to the investor service standards of the company
- ✓ Do lodge a complaint with the concerned regulator in case the company defaults in repayment of deposits (For listed companies, file complaint with SEBI; for manufacturing companies, file complaint with MCA; for banks and NBFCs, file complaint with RBI)
- ✓ Do state the name of the guardian in the application, if the deposit is in the name of a minor
- ✓ Do always have a nominee for the deposits made by you

**DON'Ts**

- ✓ Never invest all or substantial part of your savings in Fixed Deposits
- ✓ Never get lured by high interest rates
- ✓ Never forget to check on track record of the company
- ✓ Never invest in companies that care little about investor services
- ✓ Never hesitate to seek regulator's assistance for any grievance

**BANK DEPOSITS**

Bank deposits serve different purposes for different people. The purpose of deposit is to keep money safe for future needs. Keeping in view these differences, banks offer the facility of opening different types of deposit accounts by people to suit their purpose and convenience.

On the basis of the purpose they serve, bank deposit accounts may be classified as follows:

(a) Savings Bank Account

(b) Current Deposit Account

(c) Fixed Deposit Account

(d) Recurring Deposit Account

**Savings Bank Deposit Account**

If a person has limited income and wants to save money for future needs, the Saving Bank Account is most suited for his purpose. This type of account can be opened with a minimum initial deposit that varies from bank to bank. Money can be deposited any time in this account. Withdrawals can be made either by signing a withdrawal form or by issuing a cheque or by using ATM card. Normally banks put some restriction on the number of withdrawal from this account. Interest is allowed on the balance of deposit in the account. The rate of interest on savings bank account varies from bank to bank and also changes from time to time. A minimum balance has to be maintained in the account as prescribed by the bank. De-regulation of savings bank interest rates has definitely helped the customer to earn more interest. Not many banks have actually increased their rates to more than 4%, though some of the banks offer anywhere between 5.5% to 6% for deposits below ₹ 1 lakh and 6% to 7% for deposits more than ₹ 1 lakh

**Current Deposit Account**

Businessmen, companies and institutions such as schools, colleges, and hospitals have to make payment through their bank accounts. Since there is restriction on number of withdrawals from savings bank account, that type of account is not suitable for them. On this deposit, bank does not pay any interest on the balances. Rather the accountholder pays certain amount each year as operational charge. For the convenience of the accountholders, banks also allow withdrawal of amounts in excess of the balance of deposit. This facility is known as overdraft facility. It is allowed to some specific customers and up to a certain limit subject to previous agreement with the bank concerned.

**Recurring Deposit Account**

These kinds of deposits are most suitable for people who do not have lump sum amount of savings, but are ready to save a small amount every month. Normally, such deposits earn interest on the amount already deposited (through monthly instalments) at the same rates as are applicable to Fixed Deposits/Term Deposits. Under these type of deposits, the person has to usually deposit a fixed amount of money every month (usually a minimum of ₹ 100 p.m.). Any default in payment within the month attracts a small penalty. However, some Banks besides offering a fixed instalment RD, have also introduced a flexible/variable RD. Under these flexible RDs the person is allowed to deposit even higher amount of instalments, with an upper limit fixed for the same e.g. 10 times the minimum amount agreed upon.

Such accounts are normally allowed for maturities ranging from 6 months to 120 months. A Pass book is usually issued wherein the person can get the entries for all the deposits made by him/her and the interest earned. Premature withdrawal of accumulated amount permitted is usually allowed (however, penalty may be imposed for early withdrawals). These accounts can be opened in single or joint names. Nomination facility is also available.

**Fixed Deposit Account**

All Banks offer fixed deposits schemes with a wide range of tenures for periods from 7 days to 10 years. The term "fixed" in Fixed Deposits (FD) denotes the period of maturity or tenor. Therefore, the depositors are supposed to continue such Fixed Deposits for the length of time for which the depositor decides to keep the money with the bank. However, in case of need, the depositor can ask for closing (or breaking) the fixed deposit prematurely by paying a penalty (usually of 1%, but some banks either charge less or no penalty). (Some banks introduced variable interest fixed deposits. The rate of interest on such deposits keeps on varying with the prevalent market rates i.e. it will go up if the market interest rates go up and it will come down if the market rates fall. However, such type of fixed deposits has not been popular till date).

The rate of interest for Fixed Deposits differs from bank to bank (unlike previously when the same were regulated by RBI and all banks used to have the same interest rate structure).

At present, the interest rate on less than one-year fixed deposits is between 5% and 8.75% per annum and for more than one year is anywhere between 8.5% and 9.75% depending on the period of deposit

*Some Tips:*

- You should try to keep your surplus funds in Fixed Deposit for a longer duration if you feel you will not need the funds during the tenure of the deposit, as longer maturity deposits usually give higher returns. However, in recent times, banks have frequently been giving higher interest for shorter durations as such banks do not want to lock their liabilities at a higher rate of interest as they are of the view that soon interest rates will come down.

If you feel that interest rates of longer duration deposits are going to fall in future, you should opt for longer duration of fixed deposits so that you can continue to earn higher interest. If you feel that interest rates are likely to go up in near future, you should opt for the fixed deposits for short maturities, so that as and when the interest rates go up, you should be able to re-invest the funds at a higher rate.

If you plan to invest a large sum say, ₹ 1,00,000 or above, you may opt for more than one fixed deposit in different banks or branches or of different durations in the same bank , as in case of emergency, pre-mature cancellation can be got done only for one FD. (However, nowadays some banks allow pre-mature option for part withdrawals also).

If you keep large sums of money in savings account or current accounts, but want full liquidity, you may opt for schemes like 2-in1 deposits or smart deposits or auto sweep, where the bank keeps a minimum sum in your saving account all the time, and all the amounts above that will be automatically shifted to a fixed deposit. Such banks even allow automatic pre-mature cancellation as and when some cheques are presented for payment.

## MONEY MARKET INSTRUMENTS

Money market instruments are those instruments, which have a maturity period of less than one year. The most active part of the money market is the market for overnight call and term money between banks and institutions and repo transactions. Call Money/Repo are very short-term Money Market products. The below mentioned instruments are normally termed as money market instruments:

(1) Certificate of Deposit (CD)

(2) Commercial Paper (CP)

(3) Inter-Bank Participation Certificates

(4) Inter-Bank term Money

(5) Treasury Bills

(6) Bill Rediscounting

(7) Call/Notice/Term Money

### Call Money Market (Call/notice/term money)

The call money market is an integral part of the Indian Money Market, where the day-to-day surplus funds (mostly of banks) are traded.

The loans are of short-term duration varying from 1 to 14 days. The money that is lent for one day in this market is known as "Call Money", and if it exceeds one day (but less than 15 days) it is referred to as "Notice Money". Term Money refers to Money lent for 15 days or more in the Inter-Bank Market.

Banks borrow in this money market for the following purpose:

- To fill the gaps or temporary mismatches in funds
- To meet the CRR & SLR mandatory requirements as stipulated by the Central bank
- To meet sudden demand for funds arising out of large outflows

  Thus call money usually serves the role of equilibrating the short-term liquidity position of banks

**Call Money Market Participants**

1. Those who can both borrow as well as lend in the market — RBI (through LAF) Banks, PDs
2. Those who can only lend Financial institutions- LIC, UTI, GIC, IDBI, NABARD, ICICI and mutual funds, etc.

Non-Bank institutions are not permitted in the call/notice money market with effect from August 6, 2005. Reserve Bank of India has framed a time schedule to phase out the second category out of Call Money Market and make Call Money market as exclusive market for Bank/s & PD/s.

**Commercial Paper (CP)**

Commercial Papers are short-term borrowings by Corporate, FIs, Primary Dealers (PDs), from Money Market. These are sold directly by the issuers to the investors or else placed by borrowers through agents/brokers, etc.

**Features**

- Commercial Papers when issued in Physical Form are negotiable by endorsement and delivery and hence highly flexible instruments
- Issued subject to minimum of ₹ 5 lakhs and in the multiples of ₹ 5 lakhs thereafter,
- Maturity is 15 days to 1 year
- Unsecured and backed by credit of the issuing company

- Can be issued with or without Backstop facility of Bank/FI

**Eligibility Criteria**

Any private/public sector company wishing to raise money through the CP market has to meet the following requirements:

- Tangible net-worth not less than ₹ 4 crore as per last audited statement
- Should have Working Capital limit sanctioned by a bank/FI
- Credit Rating not lower than P2 or its equivalent by Credit Rating Agency approved by Reserve Bank of India
- Board resolution authorising company to issue CPs
- PD and AIFIs can also issue Commercial Papers

Commercial Papers can be issued in both physical and demat form. When issued in the physical form Commercial Papers are issued in the form of Usance Promissory Note. Commercial Papers are issued in the form of discount to the face value.

CP may be issued to and held by individuals, banking companies, other corporate bodies registered or incorporated in India and unincorporated bodies, Non-Resident Indians (NRIs) and Foreign Institutional Investors (FIIs). However, investment by FIIs would be within the limits set for their investments by Securities and Exchange Board of India (SEBI). Amount a invested by single investor should not be less than Rs. 5 lakh (face value).

**Certificate of Deposits (CD)**

This scheme was introduced in July 1989, to enable the banking system to mobilise bulk deposits from the market, which they can have at competitive rates of interest.

CDs differ from term deposit because they involve the creation of paper, and hence have the facility for transfer and multiple ownerships before maturity. CD rates are usually higher than the term deposit rates, due to the low transactions costs. Banks use the CDs for borrowing during a credit pick-up, to the extent of shortage in incremental deposits. Most CDs are held until maturity, and there is limited secondary market activity.

For the benefit of people with a low risk profile, fund houses are now creating fixed maturity plans (FMP) which invest in certificates of deposit (CDs).

**The major features are:**

*Who can issue:*

1. Scheduled commercial banks (except RRBs) and All India Financial Institutions within their `Umbrella limit'
2. CRR/SLR applicable on the issue price in case of banks
3. Investors Individuals (other than minors), corporations, companies, trusts, funds, associations, etc.

*Maturity:* Min: 7 days and Max: 12 Months (in case of FIs minimum 1 year and maximum 3 years).

*Amount:* Min: ₹ 1 lakh, beyond which in multiples of ₹ 1 lakh

*Interest rate:* Market related. Fixed or floating

*Loan against collateral of CD:* Not permitted

*Pre-mature cancellation:* Not allowed

*Transfer Endorsement & delivery:* Any time

*Nature:* Usance Promissory note. Can be issued in Dematerialisation form only w.e.f. June 30, 2002

Other conditions

- If payment day is holiday, to be paid on next preceding business day
- Issued at a discount to face value
- Duplicate can be issued after giving a public notice & obtaining indemnity

Even though CDs do not provide huge returns, they are considered a stable and reliable investment option and are preferred by many.

Like all investment avenues, CDs have their own advantages and disadvantages:

- CDs range in term from one month to 5 years and you cannot get back your money until the term is up.
- Account holders can get better interest rates if they allow a longer maturation period and are promised principal as well as interest when the CD reaches maturity.
- The interest on savings in CD accounts is fixed throughout the term of the deposit.

- A special CD arrangement allows you to withdraw the money from the interest earned. In this way, you can reap the benefits of the interest without debiting from the principal.
- There are short-term CDs which can earn 6-7% and one-year CDs which can give 9-10% per annum.
- Some safe investments like bank CDs and Savings Bonds come with fixed interest rates (for a period of time) along with a government guarantee for the safety of the principal.

To sum up, an accurately researched CD is a great way to put your money to work without having to accept high levels of risk.

***Treasury Bills***

Treasury bills are actually a class of Central Government Securities. Treasury bills, commonly referred to as T-Bills are issued by Government of India against their short-term borrowing requirements with maturities ranging between 14 and 364 days. The T-Bill of below mentioned periods are currently issued by Government/Reserve Bank of India in Primary Market: 91-day and 364-day T-Bills. All these are issued at a discount-to-face value. For example a Treasury bill of ₹ 100.00 face value issued for ₹ 91.50 gets redeemed at the end of its tenure at ₹ 100.00. 91 days T-Bills are auctioned under uniform price auction method whereas 364 days T-Bills are auctioned on the basis of multiple price auction method.

*Investors:* Treasury bills can be purchased by any one (including individuals) except State Government. These are issued by RBI and sold through fortnightly or monthly auctions at varying discount rate depending upon the bids.

*Denomination:* Minimum amount of face value ₹ 1 lakh and in multiples thereof. There is no specific amount/limit on the extent to which these can be issued or purchased.

*Maturity:* 91 days and 364 days.

*Rate of interest:* Market determined, based on demand for and supply of funds in the money market.

*Other features:*

- These are highly liquid and safe investment giving attractive yield.
- Approved assets for SLR purposes and DFHI is the market maker in these instruments and provide (daily) two way quotes to assure liquidity.

- RBI sells treasury bills on auction basis (to bidders quoting above the cut-off price fixed by RBI) every fortnight by calling bids from banks, State Government and other specified bodies.

**Treasury Bill Futures**

On the 4th July, 2011, leading stock exchange NSE launched the interest rate futures of T-91 bills. The 91-Day T-Bill futures are probably of a lot more interest to institutional investors than retail investors because not many retail investors are taking a position on interest rate movements. Most of the current trading is being done by PSUs, private banks, and corporate clients. However, there is a huge segment of retail investors who are interested in speculation, and a futures contract with relatively low margin requirements is as good a tool as any for speculative purposes.

This is an interesting product, and has already done much better in volumes than the other IRFs introduced in India.

**REPOS**

Under a repo transaction, a holder of securities sells them to an investor with an agreement to repurchase at a predetermined date and rate.

In a typical repo transaction, the counter-parties agree to exchange securities and cash, with a simultaneous agreement to reverse the transactions after a given period. To the lender of cash, the securities lent by the borrower serves as the collateral; to the lender of securities, the cash borrowed by the lender serves as the collateral. Repo thus represents a collateralised short-term lending where cost of the transaction is the repo rate. The lender of securities (who is also the borrower of cash) is said to be doing the repo; the same transaction is a *reverse repo* in the books of lender of cash (who is also the borrower of securities).

A reverse repo is the mirror image of a repo. For, in a reverse repo, securities are acquired with a simultaneous commitment to resell. Hence whether a transaction is a repo or a reverse repo is determined only in terms of who initiated the first leg of the transaction. When the reverse repurchase transaction matures, the counter-party returns the security to the entity concerned and receives its cash along with a profit spread. One factor which encourages an organization to enter into reverse repo is that it earns some extra income on its otherwise idle cash.

A repo is also sometimes called a ready forward transaction as it is a means of funding by selling a security held on a spot (ready) basis and repurchasing the same on a forward basis. Though there is no restriction on the maximum period for which repos can be undertaken, generally, repos are done for a period not exceeding 14 days. Different instruments can be considered as collateral security for undertaking the ready forward deals and they include Government dated securities, treasury bills.

Banks, PDs, institutions and corporates are permitted to undertake both repos and reverse repos.

Repos being short-term money market instruments are necessarily being used for smoothening volatility in money market rates by central banks through injection of short-term liquidity into the market as well as absorbing excess liquidity from the system.

**Inter-Bank Participation Certificates (IBPC)**

The Inter Bank Participation Certificates are short-term instruments to even out the short-term liquidity within the Banking system particularly when there are imbalances affecting the maturity mix of assets in Banking Book. The primary objective is to provide some degree of flexibility in the credit portfolio of banks. It can be issued by scheduled commercial bank and can be subscribed by any commercial bank.

The IBPC is issued against an underlying advance, classified standard and the aggregate amount of participation in any account time issue. During the currency of the participation, the aggregate amount of participation should be covered by the outstanding balance in account.

There are two types of participation certificates, with risk to the lender and without risk to the lender. Under 'with risk participation', the issuing bank will reduce the amount of participation from the advances outstanding and participating bank will show the participation as part of its advances. Banks are permitted to issue IBPC under 'with risk' nomenclature classified under Health Code-I status and the aggregate amount of such participation in any account should not exceed 40% of outstanding amount at the time of issue. The interest rate on IBPC is freely determined in the market. The certificates are neither transferable nor prematurely redeemable by the issuing bank.

Under without risk participation, the issuing bank will show the participation as borrowing from banks and participating bank will show it as advances to bank.

The scheme is beneficial both to the issuing and participating banks. The issuing bank can secure funds against advances without actually diluting its asset-mix. A bank having the highest loans to total asset ratio and liquidity bind can square the situation by issuing IBPCs.

To the lender, it provides an opportunity to deploy the short-term surplus funds in a secured and profitable manner. The IBPC with risk can also be used for capital adequacy management.

This is simple system as compared to consortium tie up.

**Bill Rediscounting**

Commercial bills can be traded by offering the bills for rediscounting. Banks provide credit to their customers by discounting commercial bills. This credit is repayable on maturity of the bill. In case of need for funds, and can rediscount the bills in the money market and get ready money.

Bills rediscounting is an important segment of the Money Market and this instrument provides short-term liquidity to banks in need of funds. The effective cost of funds raised by scheduled commercial banks through the bills rediscounting scheme is lower than the effective cost of inter-bank term deposit/loans of over 60 days as the latter are subject to reserve requirements; as such banks seeking funds through the money market find bill rediscounting very lucrative. The presence of a healthy bills market can enable the banks and also the other financial institutions to invest their surplus funds profitably by selecting appropriate maturities and it would impart flexibility to the money market by evening out liquidity in the banking system and there would be more effective monetary control. Progressive use of bills imposes financial discipline on borrowers as also on lenders.

## POST OFFICE SAVINGS SCHEMES

**Who can open?**

- A single adult or two-three adults jointly,
- A pensioner to receive/credit his monthly pension,
- Group Accounts by Provident Fund, Superannuation Fund or Gratuity Fund,
- Public Account by a local authority/body,
- An employee, contractor, or agent of a government or of a government company or of a university for depositing security amounts,
- A Gazetted Officer or an officer of a government company or corporation or Reserve Bank of India or of a local authority in his official capacity.

- A co-operative society or a co-operative bank for payment of pay, leave salary, pension contribution of government servants on deputation with such society or bank.

**Where can it be opened**

- At any post office.

**Deposit**

- Account can be opened with a minimum of ₹ 20.
- Maximum of Rupees One lakh for single holder and Rupees Two lakhs for joint holders. If depositors have more than one account (single, pension or joint), the balances or shares of balances in all such accounts taken together should not exceed ₹ One lakh for each of the depositors.

**Different Types of Post Office Saving Schemes svailable**

- Post Office Savings Account
- Post Office Recurring Deposit Account
- Post Office Monthly Income Accounts
- National Savings Certificate (VIII Issue)
- Kisan Vikas Patra
- Senior Citizen Saving Scheme (SCSS)
- Public Provident Fund Scheme
- Deposit Scheme for Retiring Government Employees
- Deposit Scheme for Retiring Employees of Public Sector Companies

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
| --- | --- | --- | --- |
| **Post Office Savings Account** | 4.0% per annum on individual/ joint accounts. | Minimum INR 20/- for opening. | • Account can be opened by cash only.<br>• Minimum balance to be maintained in a non-cheque facility account is INR 50/-.<br>• Cheque facility available if an account is opened with INR 500/- and for this purpose minimum balance of INR 500/-in an account is to be maintained.<br>• Cheque facility can be taken in an existing account also.<br>• Interest earned is Tax Free up to INR 3,500/- per year in single and INR 7,000/- in Joint account up to 2011-12 and up to INR 10,000/- per year either in single or joint account for 2012-13. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | | | • Nomination facility is available at the time of opening and also after opening of account.<br>• Account can be transferred from one post office to another.<br>• One account can be opened in one post office<br>• Account can be opened in the name of minor and a minor of 10 years and above age can open and operate the account.<br>• Joint account can be opened by two or three adults.<br>• At least one transaction of deposit or withdrawal in three financial years is necessary to keep the account active.<br>• Single account can be converted into Joint and vice versa. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | | | Minor after attaining majority has to apply for conversion of the account in his name. |
| **5-Year Post Office Recurring Deposit Account** | From 1.4.2013, interest rates are as follows:- 8.3% per annum (quarterly compounded) On maturity INR 10/- account fetches INR 744.53. Can be continued for another 5 years on year to year basis. | Minimum INR 10/- per month or any amount in multiples of INR 5/-. No maximum limit. | • Account can be opened by cash/ cheque and in case of cheque the date of deposit shall be date of presentation of cheque.<br>• Nomination facility is available at the time of opening and also after opening of account.<br>• Account can be transferred from one post office to another.<br>• Any number of accounts can be opened in any post office.<br>• Account can be opened in the name of minor and a minor of 10 years and above age can open and operate the account. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | | | • Joint account can be opened by two adults.<br>• Subsequent deposit can be made up to 15thday of next month if account is opened up to 15th of a calendar month and up to last working day of next month if account is opened between 16th day and last working day of a calendar month.<br>• If subsequent deposit is not made up to the prescribed day, a default fee is charged for each default. After 4 regular defaults, the account becomes discontinued and can be revived in two months but if the same is not revived within this period, no further deposit can be made. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | | | • There is rebate on advance deposit of at least 6 installments.<br>• Single account can be converted into Joint and vice versa.<br>• Minor after attaining majority has to apply for conversion of the account in his name.<br>• One withdrawal upto 50% of the balance allowed after one year.<br>Full maturity value allowed on R.D. Accounts restricted to that of INR. 50/- denomination in case of death of depositor subject to fulfilment of certain conditions. |
| **Post Office Time Deposit Account** | Interest payable annually but calculated quarterly. | Minimum INR 200/- and in multiple thereof. No maximum limit. | • Account may be opened by individual. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | From 1.4.2013, interest rates are as follows:-<br>Period Rate<br>1 yr. A/c 8.20%<br>2 yr. A/c 8.20%<br>3 yr. A/c 8.30%<br>5 yr. A/c 8.40% | | • Account can be opened by cash/ cheque and in case of cheque the date of realization of cheque in Govt. account shall be date of opening of account.<br>• Nomination facility is available at the time of opening and also after opening of account.<br>• Account can be transferred from one post office to another.<br>• Any number of accounts can be opened in any post office.<br>• Account can be opened in the name of minor and a minor of 10 years and above age can open and operate the account.<br>• Joint account can be opened by two adults. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | | | • Single account can be converted into Joint and Vice Versa. |
| | | | • Minor after attaining majority has to apply for conversion of the account in his name. |
| | | | • 2,3 & 5 year account can be closed after 1 year at discount. Account can also be closed after six months but before one year with interest @ post office savings account. |
| | | | The investment under 5 Years TD qualifies for the benefit of Section 80C of the Income Tax Act, 1961 from 1.4.2007. |
| Post Office Monthly Income Account Scheme | From 1.4.2013, interest rates are as follows:- | In multiples of INR 1500/-. | • Account may be opened by individual. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | 8.40% per annum payable monthly. | Maximum investment limit is INR 4.5 lakhs in single account and INR 9 lakhs in joint account. | • Account can be opened by cash/ cheque and in case of cheque the date of realization of cheque in Govt. account shall be date of opening of account. |
| | | An individual can invest maximum INR 4.5 lakh in MIS (including his share in joint accounts) | • Nomination facility is available at the time of opening and also after opening of account. |
| | | For calculation of share of an individual in joint account, each joint holder have equal share in each joint account. | • Account can be transferred from one post office to another.<br>• Any number of accounts can be opened in any post office subject to maximum investment limit by adding balance in all accounts.<br>• Account can be opened in the name of minor and a minor of 10 years and above age can open and operate the account. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | | | • Joint account can be opened by two or three adults.<br>• All joint account holders have equal share in each joint account.<br>• Single account can be converted into Joint and vice versa.<br>• Minor after attaining majority has to apply for conversion of the account in his name.<br>• Maturity period is 5 years from 1.12.2011.<br>• Interest can be drawn through auto credit into savings account standing at same post office, through PDCs or ECS. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | | | • Can be prematurely encashed after one year but before 3 years at the discount of 2% of the deposit and after 3 years at the discount of 1% of the deposit. (Discount means deduction from the deposit.)<br>A bonus of 5% on principal amount is admissible on maturity in respect of MIS accounts opened on or after 8.12.07 and up to 30.11.2011. No bonus is payable on the deposits made on or after 1.12.2011. |
| **Senior Citizen Savings Scheme** | From 1.4.2013, interest rates are as follows:-<br>9.20% per annum, payable from the date of deposit of 31st | There shall be only one deposit in the account in multiple of INR.1000/- maximum not exceeding INR 15 lakh. | • An individual of the Age of 60 years or more may open the account.<br>• An individual of the age of 55 years or more but less than 60 years who has retired on superannuation or under VRS can also open account |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | March/30th Sept/31st December in the first instance & thereafter, interest shall be payable on 31st March, 30th June, 30th Sept and 31st December. | | subject to the condition that the account is opened within one month of receipt of retirement benefits and amount should not exceed the amount of retirement benefits.<br>• Maturity period is 5 years.<br>• A depositor may operate more than one account in individual capacity or jointly with spouse (husband/ wife).<br>• Account can be opened by cash for the amount below INR 1 lakh and for INR 1 lakh and above by cheque only.<br>• In case of cheque, the date of realization of cheque in Govt. account shall be date of opening of account. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | | | • Nomination facility is available at the time of opening and also after opening of account.<br>• Account can be transferred from one post office to another<br>• Any number of accounts can be opened in any post office subject to maximum investment limit by adding balance in all accounts.<br>• Joint account can be opened with spouse only and first depositor in Joint account is the investor.<br>• Interest can be drawn through auto credit into savings account standing at same post office, through PDCs or Money Order. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | | | • Premature closure is allowed after one year on deduction of 1.5% interest & after 2 years 1% interest (Discount means deduction from the deposit.).<br>• After maturity, the account can be extended for further three years within one year of the maturity by giving application in prescribed format. In such cases, account can be closed at any time after expiry of one year of extension without any deduction.<br>• TDS is deducted at source on interest if the interest amount is more than INR 10,000/- p.a. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | | | Investment under this scheme qualifies for the benefit of Section 80C of the Income Tax Act, 1961 from 1.4.2007. |
| 15 year Public Provident Fund Account | From 1.4.2013, interest rates are as follows:-<br>8.70% per annum (compounded yearly). | Minimum INR. 500/- Maximum INR. 1,00,000/- in a financial year.<br>Deposits can be made in lump-sum or in 12 installments. | • An individual can open account with INR 5/- but has to deposit minimum of INR 500/- in a financial year and maximum INR 1,00,000/-<br>• Joint account cannot be opened.<br>• Account can be opened by cash/ cheque and In case of cheque, the date of realization of cheque in Govt. account shall be date of opening of account. |
| | | | • Nomination facility is available at the time of opening and also after opening of account. Account can be transferred from one post office to another. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | | | • The subscriber can open another account in the name of minors but subject to maximum investment limit by adding balance in all accounts.<br>• Maturity period is 15 years but the same can be extended within one year of maturity for further 5 years and so on.<br>• Maturity value can be retained without extension and without further deposits also.<br>• Premature closure is not allowed before 15 years.<br>• Deposits qualify for deduction from income under Sec. 80C of IT Act.<br>• Interest is completely tax-free. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| | | | • Withdrawal is permissible every year from 7th financial year from the year of opening account.<br>• Loan facility available from 3rd financial year.<br>No attachment under court decree order. |
| **Kisan Vikas Patra** | Discontinued from 1.12.2011 | | |
| **National Savings Certificates (NSC)**<br>**5 Years National Savings Certificate (VIII Issue)** | From 1.4.2013, interest rates are as follows:-<br>8.5% compounded six monthly but payable at maturity. INR. 100/- grows to INR 151.62 after 5 years. | Minimum INR. 100/- No maximum limit available in denominations of INR. 100/-, 500/-, 1,000/-, 5,000/- & INR. 10,000/-. | • A single holder type certificate can be purchased by, an adult for himself or on behalf of a minor or by a minor.<br>• Deposits qualify for tax rebate under Sec. 80C of IT Act.<br>• The interest accruing annually but deemed to be reinvested under Section 80C of IT Act. |

| Scheme | Interest payable, Rates, Periodicity etc. | Minimum Amount for opening of account and maximum balance that can be retained | Salient features including Tax Rebate |
|---|---|---|---|
| 10 Years National Savings Certificate (IX Issue) | 8.80% compounded six monthly but payable at maturity. INR 100/- grows to INR 236.60 after 10 years. | | |

***Source:*** *http://www.indiapost.gov.in*

**COMMODITIES**

Commodities allow a portfolio to improve overall return at the same level of risk. Unlike stocks and bonds, commodities are real assets, comprising inherent intrinsic value based on their actual commercial or industrial application. Commodities' price fluctuations do not have positive correlation with stock market and therefore, these are best tools to diversify portfolio. Moreover, investing in commodities that rise with inflation provides a natural hedge against inflation.

Therefore, commodities not only help in portfolio diversification, they also provide hedge against inflation. Hence, of late, investing in commodities has become an essential part of portfolio management.

**Who should invest?**

Any investor who wants to take advantage of price movements and wishes to diversify his portfolio can invest in commodities. However, retail and small investors should be careful while investing in commodities as the swings are volatile and lack of knowledge may result in loss of wealth.

Investors must understand the demand cycles those commodities go through and should have a view on what factors may affect this. Ideally, you should invest in select commodities that you can analyse rather than speculate across products you have no idea about.

Investing in commodities should be undertaken as a kicker in your portfolio and not as the first destination for your money.

### Commodity Trading

Commodity trading is nothing but trading in commodity spot and derivatives. If you are keen on taking a buy or sell position based on the future performance of agricultural commodities or commodities like gold, silver, metals, or crude, then you could do so by trading in commodity derivatives.

The commodity market in India clocks a daily average turnover of ₹ 12,000-15,000 crore (₹ 120-150 billion). The accumulative commodities derivatives trade value is estimated to have reached the equivalent of 66 per cent of the gross domestic product and the future will only see the percentage rise.

The Forward Markets Commission is the regulatory body for the commodity market in India. It is the equivalent of the Securities and Exchange Board of India (SEBI), which protects the interests of investors in securities.

The commodity market is driven by demand and supply factors and inventory, when it comes to perishable commodities such as agricultural products and high demand products such as crude oil. Like any market, the demand-supply equation influences the prices. Variables like weather, social changes, government policies and global factors influence the balance.

### Some Major Categories of Commodities Traded

***(1) Industrial metals***

Industrial commodities include aluminium, copper, nickel, zinc, steel, etc. The price movement of industrial commodities depends on the macro-economic factors in the world economy, for example, financial turbulence in China, border tensions in Korea, etc. These commodities do well when investors are confident about consumption demand from large economies like China. Investors can invest in industrial commodities by taking speculative future positions through a commodities broker or investing in commodities-based stocks. Though there is no one-to-one correlation between commodity prices and commodities stock price movement, if all other things are equal, commodity prices form the most important factor in the pricing of commodities-based stocks.

**(2) *Precious metals: Bullion***

This category includes precious metals like gold, silver and platinum. Gold and silver are trading at all-time high levels and experts believe there is room for further appreciation in the medium term. Investment appetite for precious metals has gone up tremendously in recent years due to global economic uncertainties. Large global investors as well as central banks in some countries are investing in precious metals to hedge against global economic uncertainties.

Investments in precious metals have given very attractive returns over the last few years. Price fluctuations in precious metals have opened opportunities for traders. People can invest in precious metals in smaller quantities at regular intervals. Investment in precious metals can be done by taking physical positions or by investing through ETFs (Exchange Traded Funds).

**(3) *Agricultural commodities***

The agricultural commodities traded are mainly sugar, channa, chilli, pepper, soya, mustard oil, etc. The price fluctuation in agriculture-based commodities depends upon various local factors, production/supply, government policies and the availability of alternatives. Trading in agricultural commodities requires knowledge and understanding of the local situations and issues. Therefore, agricultural commodities are difficult investment avenues for the small investors. However, there is a lot of price volatility in agricultural commodities which generates speculative opportunities for investors with a high risk appetite.

**(4) *Energy commodities***

Energy commodities include crude oil and natural gas. The price movement of energy commodities is driven by demand in large developed nations like USA, China, and India. We are seeing a lot of volatility in the price of energy due to global turbulence and cross currency movements. Investors with high risk appetite can look for trading opportunities in the energy commodities.

**Commodity Spot Market**

It had become very essential in the Indian context to have a spot market which is transparent and driven by demand and supply factors alone. Thus it was necessary to reduce the cost of intermediation and improve producer's realisation without increasing price paid by the consumers through making structural reforms in commodity marketing process. This is achievable by reducing cost of intermediation and creating an electronic linkage between arrival centres and consumption centres across the country.

Spot exchange was, therefore, created which is based on the principle that it provides an organized and centralized trading environment with the facility to access the market electronically & remotely and providing trading in the quality and quantity specified commodities. Some other objectives of the Exchange are:

- To provide an effective method of spot price discovery in various commodities, in a transparent manner from across the country
- To create a market where farmers can sell their produce and realize sale proceeds at the best prevailing price.
- To create a market where the processors, end users, exporters, corporate (both private and government) and other upcountry traders can procure agricultural produce at the most competitive price, without any counter party and quality risk.
- To create a transparent market where financiers, investors and arbitrageurs can invest money in buying various commodities across the country without going through the hassles of physical market.
- To provide authentic spot price of various commodities that can be used by the futures market as the benchmark price for settlement of their contracts on the date of expiry.
- To help the futures exchanges, Forward Markets Commission (FMC) and the Government in achieving the target of compulsory delivery in all agricultural produce by way of creating a structured and standardised spot market.
- To promote grading and standardisation of agricultural produce and create a market, where banks and money lending agencies can provide warehouse receipt financing to farmers and traders.

Currently, to trade in commodities in the spot market through an exchange, two options are available:

1. National Spot Exchange (NSEL) and
2. NCDEX Spot Exchange (NSPOT)

**Commodity Derivative Market**

It can be described as a derivative instrument whose value is derived from the underlying commodity. The commodity derivatives market is a direct way to invest in commodities rather than investing in the companies that trade in those commodities. For example, an investor can invest directly in a steel derivative rather than investing in the shares of Tata Steel.

The Bombay Cotton Trade Association started futures trading in 1875 and, by the early 1900s India had one of the world's largest futures industries. The Forward Contract (Regulation) Act, 1952 banned cash settlement in forward contracts and options trading. In 1960, forward trading was completely banned. Though the Government relaxed the forward contract rules in later decades, the forward market never took off later.

The government of India has issued notifications on April 1, 2003 permitting futures trading in commodities. Trading in commodity options, however, is still prohibited. The lifting of the 30-year ban on commodity futures trading in India has opened yet another avenue for investors.

**Why trade in futures?**

Futures contract in the commodities market, similar to equity derivatives segment, will facilitate the activities of speculation, hedging and arbitrage to all class of investors.

Speculation: It facilitates speculation by providing opportunity to people, although not involved with the commodity, to trade on the views in the movement of commodity prices. The speculative position is taken with a small margin amount that is paid to the exchange, and the contract can be squared-off anytime during the trading hours.

*Hedging:* Futures exchanges exist and are successful based on the principle that hedgers may forgo some profit potential in exchange for less risk of price movements and speculators will have access to increased profit potential from assuming this risk.

For example, an oil-seed farmer may go short in oil-seed futures, thus 'locking' his sale price and in the process hedging against any adverse price movements. On the other hand, a processor of oil seeds may buy oil-seed futures and thus assure him a supply of oil-seeds at a pre-determined price. Similarly the oil-seed processor may go short in oil futures, which may be bought by a wholesaler of oil.

Also, there is a saying that 'Gold shines when everything fails'. Thus, gold can be used as a hedging tool against other investments

*Arbitrage:* Traders may exploit arbitrage opportunities that arise on account of different prices between the two exchanges or between different maturities in the same underlying.

**Commodity Futures can be Traded in the following places**

- National Commodity and Derivative Exchange (NCDEX)
- Multi Commodity Exchange of India Ltd (MCX)
- National Multi Commodity Exchange of India Ltd (NMCE)
- ACE Derivatives and Commodity Exchange (ACE)
- Indian Commodity Exchange Limited (ICEX)

- Major categories of commodities one can trade
    - Vegetable Oil Seeds, Oils and Metals
    - Pulses
    - Spices
    - Metals
    - Energy products
    - Vegetables
    - Fibres and Manufactures- Cotton
    - Other – Gaurseed, Guar, Gum and Sugar

**CURRENCY**

Currency trading also is also known as foreign exchange, or forex, and it is the process of buying or selling international currencies for commerce or as an investment. By trading currencies, an investor is provided with a way to invest in a currency's future. However, currency is not traded in a financial market per se, because there is no exchange. Rather, it is totally electronic, run by a number of international banks, and it is available to investors or buyers 24 hours a day, from Sundays through Fridays.

In the past few years, this highly attractive market has become more and more accessible to individual clients. The market participants, who are linked world-wide by modern communication systems, control the prices (rates), as also this market , follows the laws of supply and demand. The special advantage of this investment as opposed to traditional investments such as fixed interest shares etc. is that profits can also be made in case of the USD falling instead of rising compared to other currencies.

The Foreign exchange market is volatile by nature. The practice of trading it by way of margin increases that volatility exponentially. In order to make a successful trade, a trader has to take into account technical and fundamental data and make an informed decision based on his perception of market sentiment and market expectation. Timing a trade correctly is probably the most important variable in trading successfully. Invariably, there will be times when a traders' timing will be off.

- While trade is international, currencies are national
- Exchange rate is affected by the supply and demand for the country's currency in the international forex market

Under the Indian Law, one can buy or sell foreign currency on current account for export, import etc. Also, trading on capital account is allowed with some restrictions. However, the regulations under Foreign Exchange Management Act (FEMA), 1999, do not permit resident Indians to do spot currency trading for speculation purpose. The forward currency market is also governed by stringent government regulations and other than authorised banks and brokers, trading on forwards is not allowed by retail participants. It is to be noted that remittances under the Liberalised Remittance Scheme are allowed only in respect of permissible capital or current account transactions or a combination of both. All other transactions, which are otherwise not permissible under FEMA, 1999, including the transactions in the nature of remittance for margins or margin calls to overseas exchanges/ overseas counterparty, are not allowed under the scheme.

**Currency Futures**

In order to provide a liquid, transparent and vibrant market for foreign exchange rate risk management, Securities & Exchange Board of India (SEBI) and Reserve Bank of India (RBI) have allowed trading in currency futures on stock exchanges for the first time in India, initially based on the USDINR exchange rate and subsequently on three other currency pairs – EURINR, GBPINR and JPYINR.

Trading in currency futures is allowed on three exchanges:

1. Multi Commodity Exchange – Stock Exchange (MCX-SX)
2. National Stock Exchange (NSE)
3. United Stock Exchange (USE)

Trading in currency futures would give Indian businesses another tool for hedging their foreign exchange risk effectively and efficiently at transparent rates on an electronic trading platform. The primary purpose of exchange-traded currency derivatives is to provide a mechanism for price risk management and consequently provide price curve of expected future prices to enable the industry to protect its foreign currency exposure. The need for such instruments increases with increase of foreign exchange volatility. These contracts also offer a better flexibility than the over-the-counter (OTC) market in terms of transparency in rates that is ensured by an electronic trading platform.

**Currency Options**

Currency Options are contracts that grant the buyer of the option the right, but not the obligation, to buy or sell underlying currency at a specified exchange rate during a specified period of time. For this right, the buyer pays premium to the seller of the option.

- Currency Options are
  - during a specified period of time
  - contract
  - that grant the buyer
  - of the option the right and
  - not the obligation to,
  - to buy or sell underlying currency
  - at a specified exchange rate
- USD-INR Option
  - Underlying is US Dollar–Indian Rupee (US$-INR) spot rate
  - USD-INR option contracts are Premium- styled European Call and Put Options.
  - The premium is quoted in rupee terms. However, the outstanding position is in USD terms

**Forex Facilities for Individuals – RBI Guidelines** *(Updated as of September 30th 2013)*

**Introduction:**

1. The legal framework for administration of foreign exchange transactions in India is provided by the Foreign Exchange Management Act, 1999. Under the Foreign Exchange Management Act, 1999 (FEMA), which came into force

with effect from June 1, 2000, all transactions involving foreign exchange have been classified either as capital or current account transactions. All transactions undertaken by a resident that do not alter his / her assets or liabilities, including contingent liabilities, outside India are current account transactions. In terms of Section 5 of the FEMA, persons resident in India[1] are free to buy or sell foreign exchange for any current account transaction except for those transactions for which drawal of foreign exchange has been prohibited by Central Government, such as remittance out of lottery winnings, remittance of income from racing/ riding, etc., or any other hobby, remittance for purchase of lottery tickets, banned / proscribed magazines, football pools, sweepstakes, etc., payment of commission on exports made towards equity investment in Joint Ventures / Wholly Owned Subsidiaries abroad of Indian companies, remittance of dividend by any company to which the requirement of dividend balancing is applicable, payment of commission on exports under Rupee State Credit Route, except commission up to 10% of invoice value of exports of tea and tobacco and payment related to "call back services" of telephones. Foreign Exchange Management (Current Account Transactions) Rules, 2000 - Notification [GSR No. 381(E)] dated May 3, 2000, as amended from time to time, is available in the Official Gazette as well as, an Annex to our Master Circular on Miscellaneous Remittances from India – Facilities for Residents available at our website www.mastercirculars.rbi.org.in.

## I. Guidelines on Travel Related Matters

**Q.1. *Who are authorized by the Reserve Bank to sell foreign exchange for travel purposes?***

**Ans.** Foreign exchange can be purchased from any authorised person, such as Authorised Dealer (AD) Category-I bank and AD Category II. Full-fledged Money Changers (FFMCs) are also permitted to release exchange for business and private visits.

***Q.2. Who is an Authorised Dealer?***

**Ans.** An Authorised Dealer is any person specifically authorised by the Reserve Bank under Section 10(1) of FEMA, 1999, to deal in foreign exchange or foreign securities (the list of ADs is available on www.rbi.org.in) and normally includes banks.

**Q.3.** ***How much foreign exchange can one buy when travelling abroad on private visits to a country outside India?***

**Ans.** For private visits abroad, other than to Nepal and Bhutan, viz., for tourism purposes, etc., any resident can obtain foreign exchange up to an aggregate amount of USD 10,000, from an Authorised Dealer, in any one financial year, on self-declaration basis, irrespective of the number of visits undertaken during the year. This limit of USD 10,000 or its equivalent per financial year for private visits can also be availed of by a person who is availing of foreign exchange for travel abroad for any purposes, such as, for employment or immigration or studies.

**No foreign exchange is available for visit to Nepal and/ or Bhutan for any purpose.**

A resident Indian is allowed to take INR of denomination of ₹ 100 or lesser denomination to Nepal and Bhutan without limit.

**Q.4.** ***How much foreign exchange is available for a business trip?***

**Ans.** For business trips abroad to countries, other than to Nepal and Bhutan, a person can avail of foreign exchange up to USD 25,000 per visit. Visits in connection with attending of an international conference, seminar, specialised training, study tour, apprentice training, etc., are treated as business visits. Release of foreign exchange exceeding USD 25,000 for business travel abroad (other than to Nepal and Bhutan), irrespective of the period of stay, requires prior permission from the Reserve Bank.

**No release of foreign exchange is admissible for any kind of travel to Nepal and Bhutan or for any transaction with persons resident in Nepal.**

Investments in Bhutan are permitted in Indian Rupees as well as in freely convertible currencies. If investment is made in freely convertible currency/ies, sale/winding up proceeds are required to be repatriated to India in freely convertible currencies.

**Q.5.** ***How much foreign currency can be taken while buying foreign exchange for travel abroad?***

**Ans.** Travellers going to all countries other than (a) and (b) below are allowed to purchase foreign currency notes / coins only up to USD 3,000. Balance amount can be carried in the form of travellers cheque or banker's draft. Exceptions to this are (a) travellers proceeding to Iraq and Libya who can draw foreign exchange in the form of foreign currency notes and coins not exceeding USD 5,000 or its equivalent; (b) travellers proceeding to the Islamic Republic of Iran, Russian Federation and other Republics of Commonwealth of Independent States who can draw entire foreign exchange in the form of foreign currency notes or coins.

**Q.6.** ***How much foreign exchange can be drawn for medical treatment abroad?***

**Ans.** AD Category-I banks and AD Category-II, may release foreign exchange up to USD 100,000 or its equivalent to resident Indians for medical treatment abroad on self-declaration basis, without insisting on any estimate from a hospital/ doctor in India/abroad. A person visiting abroad for medical treatment can obtain foreign exchange exceeding the above limit, provided the request is supported by an estimate from a hospital/doctor in India/abroad.

An amount up to USD 25,000 is allowed for maintenance expenses of a patient going abroad for medical treatment or check-up abroad, or to a person for accompanying as attendant to a patient going abroad for medical treatment/ check-up.

The amount of USD 25,000 allowed to the patient going abroad is in addition to the limit of USD 100,000 mentioned above.

**Q.7.** ***What are the facilities available to students for pursuing their studies abroad?***

**Ans.** For studies abroad the estimate received from the institution abroad or USD 100,000, per academic year, whichever is higher, may be availed of from an AD Category-I banks and AD Category-II. Students going abroad for studies are treated as Non-Resident Indians (NRIs) and are eligible for all the facilities available to NRIs under FEMA, 1999. Educational and other loans availed of by students as residents in India can be allowed to continue. A student holding NRO account may withdraw and repatriate up to USD 1 million per financial year from his NRO account. The student may avail of an amount of USD 10,000 or its equivalent for incidental expenses out of which USD 3,000 or its equivalent may be carried in the form of foreign currency while going for study abroad.

**Q. 8.** ***What are the documents required for withdrawal of Foreign Exchange for the above purpose?***

**Ans.** Documentation may be done as advised by the Authorised Dealer.

**Q.9.** ***How much foreign exchange is available to a person going abroad on employment?***

**Ans.** A person going abroad for employment can draw foreign exchange up to USD 100,000 from any Authorised Dealer in India on the basis of self-declaration.

**Q.10.** ***How much foreign exchange is available to a person going abroad on emigration?***

**Ans.** A person going abroad on emigration can draw foreign exchange from AD Category-I bank and AD Category-II up to the amount prescribed by the country of emigration or USD 100,000. He can draw foreign exchange up to USD 100,000 on self-declaration basis from an Authorised Dealer in India. This amount is only to meet the incidental expenses in the country of emigration. No amount of foreign exchange can be remitted outside India to become eligible or for earning points or credits for immigration. All such remittances require prior permission of the Reserve Bank. If requirement exceeds USD 100,000, the person requires to obtain the prior approval from the Reserve Bank.

**Q.11.** ***Is there any category of visit which requires prior approval from the Reserve Bank or the Government of India?***

**Ans.** Dance troupes, artistes, etc., who wish to undertake cultural tours abroad, should obtain prior approval from the Ministry of Human Resources Development (Department of Education and Culture), Government of India, New Delhi.

**Q.12.** ***Whether permission is required for receiving grant/ donation from abroad under the Foreign Contribution Regulation Act, 1976?***

**Ans.** The Foreign Contribution Regulation Act, 1976 is administered and monitored by the Ministry of Home Affairs whose address is given below:

*Foreigners Division, Jaisalmer House, 26, Mansingh Road, New Delhi-110 011*

No specific approval from the Reserve Bank is required in this regard.

**Q.13.** ***How many days in advance can one buy foreign exchange for travel abroad?***

**Ans.** Permissible foreign exchange can be drawn 60 days in advance. In case it is not possible to use the foreign exchange within the period of 60 days, it should be immediately surrendered to an authorised person. However, residents are free to retain foreign exchange up to USD 2,000, in the form of foreign currency notes or TCs for future use or credit to their Resident Foreign Currency (Domestic) [RFC (Domestic)] Accounts.

**Q.14.** ***Can one pay by cash full rupee equivalent of foreign exchange being purchased for travel abroad?***

**Ans.** Foreign exchange for travel abroad can be purchased from an authorised person against rupee payment in cash only up to ₹ 50,000/-. However, if the Rupee equivalent exceeds ₹ 50,000/- the entire payment should be made by way of a crossed cheque/ banker's cheque/ pay order/ demand draft/ debit card / credit card / prepaid card only.

**Q.15.** ***Is there any time-frame for a traveller who has returned to India to surrender foreign exchange?***

**Ans.** On return from a foreign trip, travellers are required to surrender unspent foreign exchange held in the form of currency notes and travellers cheques within 180 days of return. However, they are free to retain foreign exchange up to USD 2,000, in the form of foreign currency notes or TCs for future use or credit to their Resident Foreign Currency (Domestic) [RFC (Domestic)] Accounts.

**Q.16.** ***Should foreign coins be surrendered to an Authorised Dealer on return from abroad?***

**Ans.** The residents can hold foreign coins without any limit.

**Q.17.** ***How much foreign exchange can a resident individual send as gift / donation to a person resident outside India?***

**Ans.** Any resident individual, if he so desires, may remit the entire limit of USD 75,000 in one financial year under LRS as gift to a person residing outside India or as donation to a charitable/ educational/religious/cultural organisation outside India. Remittances exceeding the limit of USD 75,000 will require prior permission from the Reserve Bank.

**Q.18.** ***Is it permitted to use International Credit Card (ICC)/ ATM/Debit card for undertaking foreign exchange transactions?***

**Ans.** Use of International Credit Cards (ICCs) / ATMs/ Debit Cards can be made for travel abroad in connection with various purposes and for making personal payments like subscription to foreign journals, internet subscription, etc. The entitlement of foreign exchange on International Credit Cards (ICCs) is limited by the credit limit fixed by the card issuing authority only. With ICCs one can (i) meet expenses/make purchases while abroad (ii) make payments in foreign exchange for purchase of books and other items through internet in India. If the person has a foreign currency account in India or with a bank overseas, he/she can even obtain ICCs of overseas banks and reputed agencies. However, use of International Credit Cards/ATMs/Debit Cards is NOT permitted for prohibited transactions indicated in Schedule -1 of FEM (CAT) Rules 2000 such as purchase of lottery tickets, banned magazines etc.

**Use of these instruments for payment in foreign exchange in Nepal and Bhutan is not permitted.**

**Q.19.** ***How much Indian currency can a person carry while going abroad?***

**Ans.** Residents are free to take outside India (other than to Nepal and Bhutan) currency notes of Government of India and Reserve Bank of India notes up to an amount not exceeding ₹ 10,000 per person. They may take or send outside India (other than to Nepal and Bhutan) commemorative coins not exceeding two coins each.

*Explanation :* 'Commemorative Coin' includes coin issued by Government of India Mint to commemorate any specific occasion or event and expressed in Indian currency.

**Q.20.** ***How much Indian currency can be brought in while coming into India?***

**Ans.** A resident of India, who has gone out of India on a temporary visit may bring into India at the time of his return from any place outside India (other than Nepal and Bhutan), currency notes of Government of India and Reserve Bank of India notes up to an amount not exceeding ₹ 10,000. A person can take or send out of India to Nepal or Bhutan, currency notes of Government of India and Reserve Bank notes, in denominations not exceeding ₹ 100.

**Q.21.** ***How much foreign exchange can be brought in while visiting India?***

**Ans.** A person coming into India from abroad can bring with him foreign exchange without any limit. However, if the aggregate value of the foreign exchange in the form of currency notes, bank notes or travellers cheques brought in exceeds USD 10,000 or its equivalent and/or the value of foreign currency alone exceeds USD 5,000 or its equivalent, it should be declared to the Customs Authorities at the Airport in the Currency Declaration Form (CDF), on arrival in India.

**Q.22.** ***Is it required to follow complete export procedure when a gift parcel is sent outside India?***

**Ans.** A person resident in India is free to send (export) any gift article of value not exceeding ₹ 5,00,000 provided export of that item is not prohibited under the extant Foreign Trade Policy and the exporter submits a declaration that goods of gift are not more than ₹ 5,00,000 in value.

Export of goods or services up to ₹ 5,00,000 may be made without furnishing the declaration in Form GR/SDF/PP/SOFTEX, as the case may be.

**Q.23.** ***How much jewellery can be carried while going abroad?***

**Ans.** Taking personal jewellery out of India is as per the Baggage Rules, governed and administered by Customs Department, Government of India. While no approval of the Reserve Bank is required in this case, approvals, if any, required from Customs Authorities may be obtained.

**Q.24.** ***Can a resident extend local hospitality to a non-resident?***

**Ans.** A person resident in India is free to make any payment in Indian Rupees towards meeting expenses, on account of boarding, lodging and services related thereto or travel to and from and within India, of a person resident outside India, who is on a visit to India.

**Q.25.** ***Can residents purchase air tickets in India for their travel not touching India?***

**Ans.** Residents may book their tickets in India for their visit to any third country. For instance, residents can book their tickets for travel from London to New York, through domestic/foreign airlines in India itself.

**Q.26. *Can a resident open a foreign currency denominated account in India?***

**Ans.** Persons resident in India are permitted to maintain foreign currency accounts in India under the following three Schemes:

**a. Exchange Earner Foreign Currency Accounts**

All categories of resident foreign exchange earners can credit up to 100 per cent of their foreign exchange earnings, as specified in the paragraph 1 (A) of the Schedule to Notification No. FEMA 10/2000-RB dated 3rd May, 2000 and as amended from time to time, to their EEFC Account with an Authorised Dealer in India. Funds held in EEFC account can be utilised for all permissible current account transactions and also for approved capital account transactions as specified by the extant Rules/Regulations/Notifications/Directives issued by the Government/RBI from time to time. The account is maintained in the form of a non-interest bearing current account.

**b. Resident Foreign Currency Accounts**

A person resident in India may open, hold and maintain with an Authorised Dealer in India a Resident Foreign Currency (RFC) Account to keep their foreign currency assets which were held outside India at the time of return can be credited to such accounts. The foreign exchange received as (i) pension of any other superannuation or other monetary benefits from the employer outside India; (ii) received or acquired as gift or inheritance from a person referred to sub-section (4) of section 6 of FEMA, 1999 or (iii) referred to in clause (c) of section 9 of the Act or acquired as gift or inheritance therefrom or (iv) received as the proceeds of life insurance policy claims/maturity/surrender values settled in foreign currency from an insurance company in India permitted to undertake life insurance business by the Insurance Regulatory and Development Authority; may also be credited to this account.

RFC account can be maintained in the form of current or savings or term deposit accounts.

The funds in RFC account are free from all restrictions regarding utilisation of foreign currency balances including any restriction on investment outside India.

**c. Resident Foreign Currency (Domestic) Account**

A resident Individual may open, hold and maintain with an Authorized Dealer in India, a Resident Foreign Currency (Domestic) Account, out of foreign exchange acquired in the form of currency notes, Bank notes and travellers cheques, from any of the sources like, payment for services rendered abroad, as honorarium, gift, services rendered or in settlement of any lawful obligation from any person not resident in India. The account may also be credited with/opened out of foreign exchange earned abroad like proceeds of export of goods and/or services, royalty, honorarium, etc., and/ or gifts received from close relatives (as defined in the Companies Act) and repatriated to India through normal banking channels. The account shall be maintained in the form of Current Account and shall not bear any interest. There is no ceiling on the balances in the account. The account may be debited for payments made towards permissible current and capital account transactions.

**Q.27.** ***Can a person resident in India hold assets outside India?***

**Ans.** In terms of sub-section 4, of Section (6) of the Foreign Exchange Management Act, 1999, a person resident in India is free to hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India. (Please also refer to the Liberalised Remittance Scheme of USD 200,000 discussed below).

**II. Liberalised Remittance Scheme (LRS) of USD 75,000**

**Q.28.** ***What is the Liberalised Remittance Scheme of USD 75,000?***

**Ans.** Under the Liberalised Remittance Scheme, all resident individuals, including minors, are allowed to freely remit up to USD 75,000 per financial year (April-March) for any permissible current or capital account transaction or a combination of both. The limit was reduced from USD 200,000 to USD 75,000 with effect from August 14, 2013.

**Q.29.** ***Please provide an illustrative list of capital account transactions permitted under the scheme***

**Ans.** Under the Scheme, resident individuals can acquire and hold shares or debt instruments or any other assets outside India, without prior approval of the Reserve Bank. Individuals can also open, maintain and hold foreign currency accounts with banks outside India for carrying out transactions permitted under the Scheme.

**Q.30.** ***What are the prohibited items under the Scheme?***

**Ans.** The remittance facility under the Scheme is not available for the following:

i) Remittance for any purpose specifically prohibited under Schedule-I (like purchase of lottery tickets/sweepstakes, proscribed magazines, etc.) or any item restricted under Schedule-II of Foreign Exchange Management (Current Account Transactions) Rules, 2000;

ii) Remittance from India for margins or margin calls to overseas exchanges/overseas counterparty;

iii) Remittances for purchase of FCCBs issued by Indian companies in the overseas secondary market;

iv) Remittance for trading in foreign exchange abroad;

v) Remittance by a resident individual for acquiring immovable property;

vi) Remittances directly or indirectly to Bhutan, Nepal, Mauritius and Pakistan;

vii) Remittances directly or indirectly to countries identified by the Financial Action Task Force (FATF) as "non co-operative countries and territories", from time-to-time; and

viii) Remittances directly or indirectly to those individuals and entities identified as posing significant risk of committing acts of terrorism as advised separately by the Reserve Bank to the banks.

**Q.31.** ***Is LRS facility in addition to existing facilities detailed in Schedule III under remittances?***

**Ans.** The facility under the Scheme is in addition to those already available for private travel, business travel, studies, medical treatment, etc., as described in Schedule III of Foreign Exchange Management (Current Account Transactions) Rules, 2000. The Scheme can also be used for these purposes.

However, gift and donation remittances cannot be made separately and have to be made under the Scheme only. Accordingly, resident individuals can remit gifts and donations up to USD 75,000 per financial year under the Scheme.

Further, a resident individual can give rupee gifts to his visiting NRI/PIO close relatives [means relative as defined in Section 6 of the Companies Act, 1956] by way of crossed cheque/electronic transfer within the overall limit of USD 75,000 per financial year for the resident individual and the gifted amount should be credited to the beneficiary's NRO account. An individual resident can lend money by way of crossed cheque /electronic transfer to a Non resident Indian (NRI)/ Person of Indian Origin (PIO) close relative [means relative as defined in Section 6 of the Companies Act, 1956] within the overall limit of USD 75,000 per financial year under the Liberalised Remittance Scheme, to meet the borrower's personal or business requirements in India, subject to conditions. The loan should be interest free and have a maturity of minimum one year and cannot be remitted outside India.

**Q.32.** ***Are resident individuals under this Scheme required to repatriate the accrued interest/dividend on deposits/ investments abroad, over and above the principal amount?***

**Ans.** The investor can retain and reinvest the income earned on investments made under the Scheme. At present, the residents are not required to repatriate the funds or income generated out of investments made under the Scheme.

**Q.33.** ***Are remittances under the Scheme on gross basis or net basis (net of repatriation from abroad)?***

**Ans.** Remittance under this scheme is on a gross basis.

**Q.34.** ***Can remittances under the facility be consolidated in respect of family members?***

**Ans.** Remittances under the facility can be consolidated in respect of family members subject to the individual family members complying with the terms and conditions of the Scheme.

**Q.35.** ***Can one use the Scheme for purchase of objects of art (paintings, etc.) either directly or through auction house?***

**Ans.** Remittances under the Scheme can be used for purchasing objects of art subject to the provisions of other applicable laws such as the extant Foreign Trade Policy of the Government of India.

**Q.36.** ***Is the AD required to check permissibility of remittances based on nature of transaction or allows the same based on remitters declaration?***

**Ans.** AD will be guided by the nature of transaction as declared by the remitter and will certify that the remittance is in conformity with the instructions issued by the Reserve Bank, in this regard from time-to-time.

**Q.37.** ***Can remittance be made under this Scheme for acquisition of ESOPs?***

**Ans.** The Scheme can also be used for remittance of funds for acquisition of ESOPs.

**Q.38.** ***Is this scheme in addition to acquisition of ESOPs linked to ADR/GDR (i.e. USD 50,000/- for a block of 5 calendar years)?***

**Ans.** The remittance under the Scheme is in addition to acquisition of ESOPs linked to ADR/GDR.

**Q.39.** ***Is this Scheme in addition to acquisition of qualification shares (i.e. USD 20,000 or 1% of paid up capital of overseas company, whichever is lower)?***

**Ans.** The remittance under the Scheme is in addition to acquisition of qualification shares.

**Q.40.** ***Can a resident individual invest in units of Mutual Funds, Venture Funds, unrated debt securities, promissory notes, etc., under this scheme?***

**Ans.** A resident individual can invest in units of Mutual Funds, Venture Funds, unrated debt securities, promissory notes, etc. under this Scheme. Further, the resident can invest in such securities out of the bank account opened abroad under the Scheme.

**Q.41. Can an individual, who has availed of a loan abroad while as a non-resident Indian, can repay the same on return to India, under this Scheme as a resident?**

**Ans.** This is permissible.

**Q.42. *Is it mandatory for resident individuals to have PAN number for sending outward remittances under the Scheme?***

**Ans.** It is mandatory to have PAN number to make remittances under the Scheme.

**Q.43. *In case a resident individual requests for an outward remittance by way of issuance of a demand draft (either in his own name or in the name of the beneficiary with whom he intends putting through the permissible transactions) at the time of his private visit abroad, can the remitter effect such an outward remittance against self declaration?***

**Ans.** Such outward remittance in the form of a DD can be effected against the declaration by the resident individual in the format prescribed under the Scheme.

**Q.44. *Are there any restrictions on the frequency of the remittance?***

**Ans.** There is no restriction on the frequency. However, the total amount of foreign exchange purchased from or remitted through, all sources in India during a financial year should be within the cumulative limit of USD 75,000.

**Q.45. *What are the requirements to be complied with by the remitter?***

**Ans.** The individual will have to designate a branch of an AD through which all the remittances under the Scheme will be made. The applicants should have maintained the bank account with the bank for a minimum period of one year prior to the remittance. If the applicant seeking to make the remittance is a new customer of the bank, Authorised Dealers should carry out due diligence on the opening, operation and maintenance of the account. Further, the AD should obtain bank statement for the previous year from the applicant to satisfy themselves regarding the source of funds. If such a bank statement is not available, copies of the latest Income Tax Assessment Order or Return filed by the applicant may be obtained. He has to furnish an application-cum-declaration in the specified format regarding the purpose of the remittance and declare that the funds belong to him and will not be used for purposes prohibited or regulated under the Scheme.

**Q.46.** ***Can an individual, who has repatriated the amount remitted during the financial year, avail of the facility once again?***

**Ans.** Once a remittance is made for an amount up to USD 75,000 during the financial year, he would not be eligible to make any further remittances under this scheme, even if the proceeds of the investments have been brought back into the country.

**Q.47.** ***Can remittances be made only in US Dollars?***

**Ans.** The remittances can be made in any freely convertible foreign currency equivalent to USD 75,000 in a financial year.

**Q.48.** ***In the past resident individuals could invest in overseas companies listed on a recognised stock exchange abroad and which have the shareholding of at least 10 per cent in an Indian company listed on a recognised stock exchange in India. Does this condition still exist?***

**Ans.** Investment by resident individuals in overseas companies is subsumed under the Scheme of USD 75,000. The requirement of 10 per cent reciprocal shareholding in the listed Indian companies by such overseas companies has since been dispensed with.

## III. Guidelines for Financial Intermediaries offering special schemes, protection under the Scheme

**Q.49.** ***Are intermediaries expected to seek specific approval for making overseas investments available to clients?***

**Ans.** Banks including those not having operational presence in India are required to obtain prior approval from Reserve Bank for soliciting deposits for their foreign/overseas branches or for acting as agents for overseas mutual funds or any other foreign financial services company.

**Q.50.** ***Are there any restrictions on the kind/quality of debt or equity instruments an individual can invest in?***

**Ans.** No ratings or guidelines have been prescribed under the Liberalised Remittance Scheme of USD 75,000 on the quality of the investment an individual can make. However, the individual investor is expected to exercise due diligence while taking a decision regarding the investments which he or she proposes to make.

**Q.51.** ***Would credit facilities in Indian Rupees or foreign currency be permissible against security of such deposits?***

**Ans.** No. The Scheme does not envisage extension of credit facility against the security of the deposits. Further, the banks should not extend any kind of credit facilities to resident individuals to facilitate remittances under the Scheme.

**Q.52.** ***Can bankers open foreign currency accounts in India for residents under the Scheme?***

**Ans.** No. Banks in India cannot open foreign currency accounts in India for residents under the Scheme.

**Q.53.** ***Can an Offshore Banking Unit (OBU) in India be treated on par with a branch of the bank outside India for the purpose of opening of foreign currency accounts by residents under the Scheme?***

**Ans.** No. For the purpose of the Scheme, an OBU in India is not treated as an overseas branch of a bank in India.

**Q.54.** ***Are individuals resident in India permitted to include non-resident close relatives as joint holder(s) in their resident bank accounts?***

**Ans.** Individuals resident in India are permitted to include non-resident close relative(s) (relatives as defined in Section 6 of the Companies Act, 1956) as joint holder(s) in their resident bank accounts on 'former or survivor' basis. However, such non-resident Indian close relatives shall not be eligible to operate the account during the life time of the resident account holder.

**Q.55.** ***Can a Non-Resident Indian (NRI) open NRE/FCNR (B) account with their resident close relative?***

**Ans.** Non-Resident Indian (NRI), as defined in FEMA Notification No. 5/ 2000-RB dated May 3, 2000 may be permitted to open NRE/FCNR(B) account with their resident close relative (relative as defined in Section 6 of the Companies Act, 1956) on 'former or survivor' basis. The resident close relative shall be eligible to operate the account as a Power of Attorney holder in accordance with the extant instructions during the life time of the NRI/PIO account holder.

**Q.56.** ***Can a resident individual make a rupee gift to a NRI/PIO who is a close relative of resident individual by of crossed cheque/ electronic transfer?***

**Ans.** A resident individual is permitted to make a rupee gift to a NRI/PIO who is a close relative of the resident individual {close relative as defined in Section 6 of the Companies Act, 1956} by way of crossed cheque/electronic transfer. The amount should be credited to the Non-Resident (Ordinary) Rupee Account (NRO) Account of the NRI/PIO and credit of such gift amount may be treated as an eligible credit to NRO account. The gift amount would be within the overall limit of USD 75,000 per financial year as permitted under the Liberalised Remittance Scheme (LRS) for a resident individual. It would be the responsibility of the resident donor to ensure that the gift amount being remitted is under the LRS and all the remittances under the LRS during the financial year including the gift amount have not exceeded the limit prescribed under the LRS.

**Q.57.** ***Are resident individuals permitted to lend to a Non-resident Indian (NRI)/Person of Indian Origin (PIO)?***

**Ans.** A resident individual may now lend to a Non resident Indian (NRI)/ Person of Indian Origin (PIO) close relative [means relative as defined in Section 6 of the Companies Act, 1956] by way of crossed cheque /electronic transfer, subject to the following conditions:

(i) the loan is free of interest and the minimum maturity of the loan is one year;

(ii) the loan amount should be within the overall limit under the Liberalised Remittance Scheme of USD 75,000 per financial year available for a resident individual. It would be the responsibility of the lender to ensure that the amount of loan is within the Liberalised Remittance Scheme limit of USD 75,000 during the financial year;

(iii) the loan shall be utilised for meeting the borrower's personal requirements or for his own business purposes in India;

(iv) The loan shall not be utilised, either singly or in association with other person, for any of the activities in which investment by persons resident outside India is prohibited, namely;

(a) The business of chit fund, or

(b) Nidhi Company, or

(c) Agricultural or plantation activities or in real estate business, or construction of farm houses, or

(d) Trading in Transferable Development Rights (TDRs).

Explanation: For the purpose of item (c) above, real estate business shall not include development of townships, construction of residential/commercial premises, roads or bridges.

(v) The loan amount should be credited to the NRO a/c of the NRI/PIO. Credit of such loan amount may be treated as an eligible credit to NRO a/c;

(vi) The loan amount shall not be remitted outside India; and

(vii) Repayment of loan shall be made by way of inward remittances through normal banking channels or by debit to the Non-resident Ordinary (NRO)/Non-resident External (NRE)/Foreign Currency Non-resident (FCNR) account of the borrower or out of the sale proceeds of the shares or securities or immovable property against which such loan was granted.

**Q.58.** ***Can the loans of Non-Resident be repaid by close relatives resident in India ?***

**Ans.** Where an authorised dealer in India has granted loan to a non-resident Indian in accordance with Regulation 7 of the Notification No. FEMA 4/2000-RB dated May 3, 2000 such loans may also be repaid by a resident close relative (relative as defined in Section 6 of the Companies Act, 1956) of the Non-Resident Indian by crediting the borrower's loan account through the bank account of such relative.

**Q.59.** ***Is meeting of medical expenses of NRIs' close relatives by Resident Individuals permitted?***

**Ans.** Where the medical expenses in respect of NRI close relative (relative as defined in Section 6 of the Companies Act, 1956) are paid by a resident individual, such a payment being in the nature of a resident to resident transaction may be covered under the term "services related thereto" under Regulation 2(i) of Notification No. FEMA16/ 2000-RB dated May 3, 2000.

## DERIVATIVES

Derivatives, such as futures or options, are financial contracts which derive their value from a spot price, which is called the "underlying". For example, wheat farmers may wish to enter into a contract to sell their harvest at a future date to eliminate the risk of a change in prices by that date. Such a transaction would take place through a forward or futures market. This market is the "derivatives market", and the prices of this market would be driven by the spot market price of wheat which is "underlying". The term "contracts" is often applied to denote the specific traded instrument, whether it is a derivative contract in wheat, gold or equity shares. The world over, derivatives are a key part of the financial system. The most important contract types are futures and options, and the most important underlying markets are equity, treasury bills, commodities, foreign exchange, real estate etc.

- Financial contracts which derive their value from a spot price are called the underlying
- Derivative Instruments traded are Futures and Options
- Derivative Exchange/Segment function as a Self-Regulatory Organization and SEBI Acts as the oversight regulator
- Futures contracts, Index Options, Stock options, Stock Futures, Mini Derivative contract on Index, Long tenure Index Option contracts, Volatility Index, Bond Index and Exchange traded Currency Derivatives are permitted by SEBI

With Securities Laws (Second Amendment) Act, 1999, Derivatives have been included in the definition of Securities. The term Derivative has been defined in Securities Contracts (Regulations) Act, as:—

A Derivative includes

B. A security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;

C. A contract which derives its value from the prices, or index of prices, of underlying securities;

**Forward Contract**

In a forward contract, two parties agree to do a trade at some future date, at a stated price and quantity. No money changes hands at the time the deal is signed.

**Forward Contracting is Useful**

Forward contracting is very valuable in hedging and speculation. The classic hedging application would be that of a wheat farmer forward -selling his harvest at a known price in order to eliminate price risk. Conversely, a bread factory may want to buy bread forward in order to assist production planning without the risk of price fluctuations. If a speculator has information or analysis which forecasts an upturn in a price, then he can go long on the forward market instead of the cash market. The speculator would go long on the forward, wait for the price to rise, and then take a reversing transaction making a profit.

**Problems of Forward Markets**

Forward markets worldwide are afflicted by several problems:

(a) Lack of centralisation of trading,

(b) Illiquidity, and

(c) Counterparty risk.

In the first two of these, the basic problem is that of too much flexibility and generality. The forward market is like the real estate market in that any two persons can form contracts against each other. This often makes them design terms of the deal which are very convenient in that specific situation for the specific parties, but makes the contracts non-tradable if more participants are involved. Also the "phone market" here is unlike the centralisation of price discovery that is obtained on an exchange, resulting in an illiquid market place for forward markets. Counterparty risk in forward markets is a simple idea: when one of the two sides of the transaction chooses to declare bankruptcy, the other suffers. Forward markets have one basic issue: the larger the time period over which the forward contract is open, the larger are the potential price movements, and hence the larger is the counter-party risk. Even when forward markets trade standardised contracts, and hence avoid the problem of illiquidity, the counterparty risk remains a very real problem.

**Futures Contract**

Futures markets were designed to solve all the three problems of forward markets. Futures markets are exactly like forward markets in terms of basic economics. However, contracts are standardised and trading is centralised (on a stock exchange). There is no counterparty risk (thanks to the institution of a clearing corporation which becomes counterparty to both sides of each transaction and guarantees the trade). In futures markets, unlike in forward markets, increasing the time to expiration does not increase the counterparty risk. Futures markets are highly liquid as compared to the forward markets.

**Forward Rate Agreement**

A forward rate agreement is an agreement to lend money on a particular date in the future at a rate that is determined today. It is like a forward contract where the underlying asset is a bond.

**Interest Rate Swaps**

Interest rate swaps are agreements where one side pays the other a particular interest rate (fixed or floating) and the other side pays the other a different interest rate (fixed or floating).

*Accordingly, swaps are:*

Fixed v/s. Floating swaps: Where one side pays the other a fixed interest rate and the other pays a floating rate determined by some benchmark and reset at fixed time intervals.

*Basis swaps:* Where the two sides pay each other rates determined by different benchmarks.

**Overnight Interest Swaps**

Overnight interest rate swaps are currently prevalent to the largest extent. They are swaps where the floating rate is an overnight rate (such as NSE, MIBOR) and the fixed rate is paid in exchange of the compounded floating rate over a certain period.

**Various types of derivative instruments traded on the Exchange**

There are two types of derivatives instruments traded on an Exchange; namely Futures and Options:

> *Futures:* A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price. All the futures contracts are settled in cash at NSE.
>
> *Options:* An Option is a contract which gives the right, but not an obligation, to buy or sell the underlying at a stated date

and at a stated price. While a buyer of an option pays the premium and buys the right to exercise his option, the writer of an option is the one who receives the option premium and is therefore obliged to sell/buy the asset if the buyer exercises it on him/her.

*Options are of two types - Calls and Puts options:*

"Calls" give the buyer the right but not the obligation to buy a given quantity of the underlying asset, at a given price on or before a given future date.

"Puts" give the buyer the right, but not the obligation to sell a given quantity of underlying asset at a given price on or before a given future date. All the options contracts are settled in cash.

Further the Options are classified based on type of exercise. At present the Exercise style can be European or American.

*American Option:* American options are options contracts that can be exercised at any time up to the expiration date.

*European Options:* European options are options that can be exercised only on the expiration date.

**Trading in Derivatives**

Futures trading will be of interest to those who wish to:

(1) *Invest:* take a view on the market and buy or sell accordingly.

(2) *Price Risk Transfer – Hedging:* Hedging is buying and selling futures contracts to offset the risks of changing underlying market prices. Thus it helps in reducing the risk associated with exposures in underlying market by taking counter-positions in the futures market. For example, an investor who has purchased a portfolio of stocks may have a fear of adverse market conditions in future which may reduce the value of his portfolio. He can hedge against this risk by shorting the index which is correlated with his portfolio, say the Nifty 50. In case the markets fall, he would make a profit by squaring off his short Nifty 50 position.

This profit would compensate for the loss he suffers in his portfolio as a result of the fall in the markets.

(3) *Leverage:* Since the investor is required to pay a small fraction of the value of the total contract as margins, trading

in Futures is a leveraged activity since the investor is able to control the total value of the contract with a relatively small amount of margin. Thus the Leverage enables the traders to make a larger profit (or loss) with a comparatively small amount of capital.

*Options trading will be of interest to those who wish to:*

(1) Participate in the market without trading or holding a large quantity of stock.

(2) Protect their portfolio by paying small premium amount.

*Benefits of trading in Futures and Options:*

(1) Able to transfer the risk to the person who is willing to accept them

(2) Incentive to make profits with minimal amount of risk capital

(3) Lower transaction costs

(4) Provides liquidity, enables price discovery in underlying market

(5) Derivatives market is lead economic indicators.

**Concept of 'In- the- money', 'At- the- money' and 'Out- of-the- money' in respect of Options**

*In-the-money options (ITM):* An in-the-money option is an option that would lead to positive cash flow to the holder if it were exercised immediately. A Call option is said to be in-the-money when the current price stands at a level higher than the strike price. If the Spot price is much higher than the strike price, a Call is said to be deep in-the-money option. In the case of a Put, the put is in-the-money if the Spot price is below the strike price.

*At-the-money-option (ATM):* An at-the money option is an option that would lead to zero cash fl ow if it were exercised immediately. An option on the index is said to be "at-the-money" when the current price equals the strike price.

*Out-of-the-money-option (OTM):* An out-of-the-money Option is an option that would lead to negative cash flow if it were exercised immediately. A Call option is out-of-the-money when the current price stands at a level which is less than the strike price. If the current price is much lower than the strike price the call is said to be deep out-of-the money. In case of a Put, the Put is said to be out-of-money if current price is above the strike price.

### Structure of Derivative Markets in India

Derivative trading in India takes can place either on a separate and independent Derivative Exchange or on a separate segment of an existing Stock Exchange. Derivative Exchange/Segment function as a Self-Regulatory Organisation (SRO) and SEBI acts as the oversight regulator. The clearing & settlement of all trades on the Derivative Exchange/Segment would have to be through a Clearing Corporation/ House, which is independent in governance and membership from the Derivative Exchange/Segment.

## EXCHANGE TRADED FUNDS

ETFs are basket of securities which are traded on an exchange just like individual stocks. So, they work like investment funds which hold assets such as stocks, commodities or bonds and trades at approximately the same price as the net asset value of its underlying assets over the course of the trading day.

Think of it as a Mutual Fund that you can buy and sell in real-time at a price that change throughout the day. But unlike traditional mutual funds, ETFs do not sell or redeem their individual shares at net asset value, or NAV.

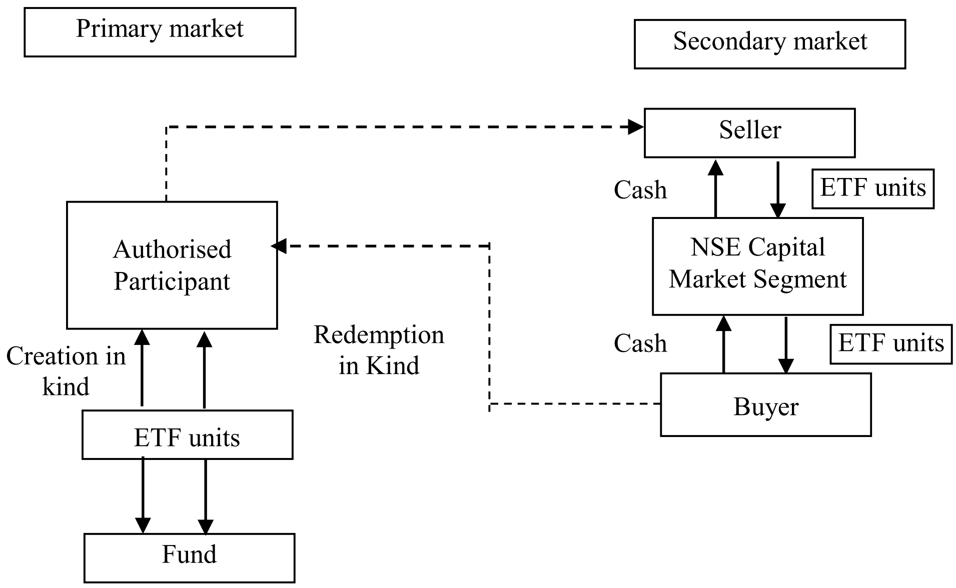
### Creation and Redemption

ETFs are different from mutual funds in the sense that ETF units are not sold to the public for cash. Instead, financial institutions purchase and redeem ETF shares directly from the ETF, but only in large blocks, varying in size by ETF from 25,000 to 200,000 shares, called "creation units". Purchases and redemptions of the creation units generally are in kind, with the institutional investor contributing or receiving a basket of securities of the same type and proportion held by the ETF, although some ETFs may require or permit a purchasing or redeeming shareholder to substitute cash for some or all of the securities in the basket of assets.

The number of outstanding ETF units is not limited, as with traditional mutual funds. It may increase if investors deposit shares to create ETF units; or it may reduce on a day if some ETF holders redeem their ETF units for the underlying shares. These transactions are conducted by sending creation/redemption instructions to the Fund. The Portfolio Deposit closely approximates the proportion of the stocks in the index together with a specified amount of Cash Component. This "in-kind" creation/redemption facility ensures that ETFs trade close to their fair value at any given time.

Some investors may prefer to hold the creation units in their portfolios. While others may break-up the creation units and sell on the exchanges, where individual investors may purchase them just like any other shares.

ETF units are continuously created and redeemed based on investor demand. Investors may use ETFs for investment, trading or arbitrage. The price of the ETF tracks the value of the underlying index. This provides an opportunity to investors to compare the value of underlying index against the price of the ETF units prevailing on the Exchange. If the value of the underlying index is higher than the price of the ETF, the investors may redeem the units to the Sponsor in exchange for the higher priced securities. Conversely, if the price of the underlying securities is lower than the ETF, the investors may create ETF units by depositing the lower-priced securities. This arbitrage mechanism eliminates the problem associated with closed-end mutual funds viz. the premium or discount to the NAV.




## 2. Benefits of ETF

ETFs provide exposure to an index or a basket of securities that trade on the exchange like a single stock. They offer a number of advantages over traditional open-ended index funds as follows:

- While redemptions of Index fund units takes place at a fixed NAV price (usually end of day), ETFs offer the convenience of intra-day purchase and sale on the Exchange, to take advantage of the prevailing price, which is close to the actual NAV of the scheme at any point in time.

- They provide investors a fund that closely tracks the performance of an index throughout the day with the ability to buy/sell at any time, whereby trading opportunities that arise during a day may be better utilised.
- They are low cost.
- Unlike listed closed-ended funds, which trade at substantial premium or more frequently at discounts to NAV, ETFs are structured in a manner which allows Authorized Participants and Large Institutions to create new units and redeem outstanding units directly with the fund, thereby ensuring that ETFs trade close to their actual NAVs.
- ETFs are like any other index fund, wherein, subscription/ redemption of units work on the concept of exchange with underlying securities instead of cash (for large deals).
- Since an ETF is listed on an Exchange, costs of distribution are much lower and the reach is wider. These savings in cost are passed on to the investors in the form of lower costs. Further, the structure helps reduce collection, disbursement and other processing charges.
- ETFs protect long-term investors from inflows and outflows of short-term investors. This is because the fund does not incur extra transaction cost for buying/selling the index shares due to frequent subscriptions and redemptions.
- Tracking error, which is divergence between the NAV of the ETF and the underlying Index, is generally observed to be low as compared to a normal index fund due to lower expenses and the unique in-kind creation/redemption process.
- ETFs are highly flexible and can be used as a tool for gaining instant exposure to the equity markets, equitising cash or for arbitraging between the cash and futures market.

## MUTUAL FUNDS

A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities.

The income earned through these investments and the capital appreciation realised is shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

There are two-steps to identify a suitable mutual fund:

- Selecting a fund with investment objectives and preferences, return objectives, time horizon and risk tolerances that meet the requirements of the investor.
- Selecting a fund that has a detailed asset allocation strategy by fund type category to reflect the investment objectives of the fund.

The Indian Equity Market has grown significantly in the recent years; Mutual Funds are not left far behind. Both the avenues have created wealth for the investors. But for the creation of wealth through this avenue a proper understanding of the Mutual Funds is must.

**Regulatory structure of Mutual funds**

- Operation of mutual funds is controlled by SEBI
- The RBI controls money market mutual funds
- UTI has its own Guidelines

**Purchase of Mutual Fund Schemes**

New Fund Offering (NFO) is a new scheme launched by a mutual fund to collect funds from the investors. Investors can also contact agents and distributors of mutual funds for necessary information and application forms. The units of existing schemes can be purchased directly from the fund itself or from distributors/brokers/sub-brokers/agents.

**Investing in mutual fund schemes**

**DOs**

✓ Read the offer document carefully before investing

✓ Investments in mutual funds may be risky, and do not necessarily result in gains

✓ Invest in a scheme depending upon your investment objective and risk appetite

✓ Note that past performance of a scheme or a fund is not indicative of the scheme's or the fund's future performance. Past performance may or may not be sustained in the future

✓ Keep regular track of the NAV of the schemes in which you have invested

✓ Ensure that you receive an account statement for your investments/ redemptions

**DON'Ts**

- Never invest in a scheme just because somebody is offering you a commission or some other incentive, gift etc.
- Never get carried away by the name of the scheme/ mutual fund
- Never be guided solely by the past performance of a scheme/ fund
- Never forget to take note of the risks involved in the investment
- Never hesitate to approach the proper authorities for redressal of your doubts/grievances
- Never deal with any agent/broker dealer who is not registered with AMFI

**Different terms associated with Mutual Funds**

**Net Asset Value (NAV)**

Net Asset Value is the market value of the assets of the scheme minus its liabilities. Per unit NAV is the net asset value of the scheme divided by the number of units outstanding on the Valuation Date.

**Sale Price**

Sale price is the price you pay when you invest in a scheme. This is also called Offer Price. It may include a sales load.

**Repurchase Price**

Repurchase price is the price at which a close-ended scheme repurchases its units and it may include a back-end load. This is also called Bid Price.

**Redemption Price**

Redemption Price is the price at which open-ended schemes repurchase their units and close-ended schemes redeem their units on maturity. Such prices are NAV related.

**Sales Load**

Sales Load is a charge collected by a scheme when it sells the units. This is also called, 'Front-end' load. Schemes that do not charge a load are called 'No Load' schemes.

**Repurchase or 'Back-end' Load**

This is a charge collected by a scheme when it buys back the units from the unit holders.

**Advantages of investing in a Mutual Fund**

The benefits of investing through a mutual fund are:

(1) *Affordability:* Mutual funds allow you to invest small sums. For instance, if you want to buy a portfolio of blue chips of modest size, you should at least have a few lakhs of rupees. A mutual fund gives you the same portfolio for meager investment of ₹ 1,000-5,000. A mutual fund can do that because it collects money from many people and it has a large corpus.

(2) *Professional management:* The major advantage of investing in a mutual fund is that you get a professional money manager to manage your investments for a small fee. You can leave the investment decisions to him and only have to monitor the performance of the fund at regular intervals.

(3) *Diversification:* Considered the essential tool in risk management; mutual funds make it possible for even small investors to diversify their portfolio. A mutual fund can effectively diversify its portfolio because of the large corpus. However, a small investor cannot have a well-diversified portfolio because it calls for large investment. For example, a modest portfolio of 10 blue-chip stocks calls for a few thousand.

(4) *Convenience:* Mutual funds offer tailor-made solutions like systematic investment plans and systematic withdrawal plans to investors, which is very convenient to investors. Investors also do not have to worry about investment decisions, they do not have to deal with brokerage or depository, etc. for buying or selling of securities.

    Mutual funds also offer specialised schemes like retirement plans, children's plans, industry specific schemes, etc. to suit personal preference of investors. These schemes also help small investors with asset allocation of their corpus. It also saves a lot of paper work.

(5) *Cost-Effectiveness:* A small investor will find that the mutual fund route is a cost-effective method (the AMC fee is normally 2.5%) and it also saves a lot of transaction cost as mutual funds get concession from brokerages. Also, the investor gets the service of a financial professional for a very small fee. If he were to seek a financial advisor's help directly, he will end up paying significantly more for investment advice. Also, he will need to have a sizeable corpus to offer for investment management to be eligible for an investment adviser's services.

(6) *Liquidity:* You can liquidate your investments within 3 to 5 working days (mutual funds dispatch redemption cheques speedily and also offer direct credit facility into your bank account i.e. Electronic Clearing Services).

(7) *Tax breaks:* You do not have to pay any taxes on dividends issued by mutual funds. You also have the advantage of capital gains taxation. Tax-saving schemes and pension schemes give you the added advantage of benefits under section 80C

(8) *Transparency:* Mutual funds offer daily NAVs of schemes, which help you to monitor your investments on a regular basis. They also send quarterly newsletters, which give details of the portfolio, performance of schemes against various benchmarks, etc. They are also well regulated and SEBI monitors their actions closely.

**Types of Mutual Fund Schemes**

A wide variety of Mutual Fund Schemes exists to cater to the needs of investors such as financial position, risk tolerance and return expectations etc. The table below gives an overview into the existing types of schemes in the Industry.

*By structure:*

- Open-ended schemes
- Close-ended schemes
- Interval schemes

*By Investment Objective:*

- Growth schemes
- Diversified Equity schemes

- Income schemes
- Balanced schemes
- Money market schemes

*Other Schemes:*

- Gilt Fund schemes
- Index schemes
- Sector specific schemes
- Tax savings schemes
- Hybrid schemes
- Fund of Fund schemes
- Floating Rate schemes

**Schemes According to Maturity Period**

A mutual fund scheme can be classified into open-ended scheme or close-ended scheme depending on its maturity period.

- ***Open-ended Fund/Scheme:*** An open-ended fund or scheme is one that is available for subscription and repurchase on a continuous basis. These schemes do not have a fixed maturity period. Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices that are declared on a daily basis. The key feature of open-ended schemes is liquidity.
- ***Close-ended Fund/Scheme:*** A close-ended fund or scheme has a stipulated maturity period e.g., 5-7 years. The fund is open for subscription only during a specified period at the time of launch of the scheme. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where the units are listed. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices. SEBI Regulations stipulate that at least one of the two exit routes is provided to the investor i.e., either repurchase facility or through listing on stock exchanges. These mutual funds schemes disclose NAV generally on weekly basis.
- ***Interval funds:*** In India, mutual funds are categorised as open-ended schemes or closed-ended schemes. With an open-

ended scheme, investors can enter and exit the scheme at any time. With a closed-ended scheme, investors can enter during the NFO period and exit upon the end of the tenure of the fund.

Interval funds are a hybrid between these two models. While they can be invested in during the NFO time, there are specified pre-determined time slots during which redemptions/ re-investments can be made from/into the fund. Example funds in this category are HDFC Quarterly Interval Plan and Birla Sunlife's Income quarterly series funds.

*Schemes according to Investment Objective*

A scheme can also be classified as growth scheme, income scheme, or balanced scheme considering its investment objective. Such schemes may be open-ended or close-ended schemes as described earlier. Such schemes may be classified mainly as follows:

- ***Growth/Equity Oriented Scheme:*** The aim of growth funds is to provide capital appreciation over the medium to long-term. Such schemes normally invest a major part of their corpus in equities. Such funds have comparatively high risks. These schemes provide different options to the investors like dividend option, capital appreciation, etc. and the investors may choose an option depending on their preferences. The investors must indicate the option in the application form. The mutual funds also allow the investors to change the options at a later date. Growth schemes are good for investors having a long-term outlook seeking appreciation over a period of time.
- ***Diversified Equity mutual funds:*** These are the bread and butter of the retail mutual fund industry. These funds invest in stocks across the equity market according to their mandate. They are further classified into large-cap funds, small and mid cap funds, micro cap funds depending on the market capitalisation they invest in. They could also be classified as active or passive funds (such as index funds) depending on how they are managed. Broadly diversified funds created as tax saving vehicles also fall in this category. Funds such as HDFC Top 200, Franklin India Bluechip, DSP Blackrock Top 100, ICICI Prudential Dynamic, Reliance Regular savings equity fund fall under this category.
- ***Income/Debt Oriented Scheme:*** The aim of income funds is to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as

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

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

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

*Other schemes:*

- ***Gilt Fund***: These funds invest exclusively in government securities. Government securities have no default risk. NAVs of these schemes also fluctuate due to change in interest rates and other economic factors as is the case with income or debt oriented schemes. . Examples of such schemes are Birla Sunlife Gilt Long term, HDFC Gilt Long term, and ICICI Prudential Gilt Investment funds.

- ***Index Funds:*** Index Funds replicate the portfolio of a particular index such as the BSE Sensitive index, S&P NSE 50 index (Nifty), etc .These schemes invest in the securities in the same weight age comprising of an index. NAVs of such schemes would rise or fall in accordance with the rise or fall in the index, though not exactly by the same percentage due to some factors known as "tracking error" in technical terms. Necessary disclosures in this regard are made in the offer document of the mutual fund scheme.

There are also exchange traded index funds launched by the mutual funds which are traded on the stock exchanges.

- ***Sector specific funds/schemes***: These are the funds/ schemes that invest in the securities of only those sectors or industries as specified in the offer documents. e.g., Pharmaceuticals, Software, Fast Moving Consumer Goods (FMCG), Petroleum stocks, etc. The returns in these funds are dependent on the performance of the respective sectors/ industries. While these funds may give higher returns, they are more risky compared to diversified funds. Investors need to keep a watch on the performance of those sectors/ industries and must exit at an appropriate time. They may also seek advice of an expert. Funds such as ICICI Prudential Infrastructure, Reliance Banking Retail, Franklin Pharma fund fall in this category

- ***Tax Saving Schemes:*** These schemes offer tax rebates to the investors under specific provisions of the Income Tax Act, 1961 as the Government offers tax incentives for investment in specified avenues. E.g. Equity Linked Savings Schemes (ELSS). Pension schemes launched by the mutual funds also offer tax benefits. These schemes are growth oriented and invest pre-dominantly in equities. Their growth opportunities and risks associated are like any equity-oriented scheme.

- ***Hybrid funds***: These funds invest in a mix of debt and equity markets (also include Gold in some cases). They could be debt-oriented funds – also called monthly income plans - that invest predominantly in debt instruments and about 15-20% in the equity market. Or they could be equity-oriented hybrid funds – sometimes called balanced funds – that invest predominantly (at least 65%) in the equity market. Popular funds in this category are HDFC Prudence, Reliance MIP, DSP Blackrock Balanced and others.

- ***Fund of Funds:*** These are mutual funds that invest in other mutual funds. Why would such funds exist, what would be the reason for creating them? There are three possible reasons:

One, they could be asset allocation funds that could invest in debt and equity in dynamic proportions. Instead of manage both the ratio and the underlying investments, it would be better for the fund to manage only the debt:equity ratio and leave the management of debt and equity to other fund managers. This can be achieved if the fund invests in other funds. Example of such a fund is, as mentioned earlier, the Franklin Templeton Dynamic PE ratio fund of funds.

Second, they could be providing a single-point solution for portfolio management. Every investor wants to invest in more than one mutual fund to achieve broad market diversification and to choose best of breed funds across fund houses. So, why not have a fund of fund that does this for the investor, and manages the distribution across the various schemes? For an investor, this fund of fund would practically work like an advisory solution for their portfolio. Quantum mutual fund's Equity Fund of Fund is one such fund.

Third, there are situations where a mutual fund is a more convenient vehicle for investing in an underlying asset than directly in the asset itself. For example, investing in an exchange-traded fund requires a demat/brokerage account that is not required for investing in a mutual fund. So, a fund of fund that invests in an ETF provides the convenience of investing in the same ETF without demat account to the investors. Recent Gold offerings such as Reliance Gold savings fund belong to this category.

Investors need to be aware of increased expenses when choosing to invest in Fund of funds. The top-level fund charges additional fund management fees of up to 0.75% on top of the fees of the underlying funds. However, some fund of funds such as the Reliance Gold savings fund provide a cap for the total combined expenses.

- ***Floating rate funds***: Typically debt funds invest in deposit instruments that have a fixed interest rate or coupon rate. They invest in a diverse set of such fixed rate instruments of different tenures and manage a portfolio of these assets. However, floating rate funds invest in instruments whose rates are not fixed. They move with the prevailing interest rates – up or down. Theoretically, such funds provide an attractive opportunity to investors because the yield on their investments will move with the interest rates and thus provide a cushion from the interest rate risk. However, in reality, there is a paucity of such floating rate debt instruments to invest in the Indian debt market. Due to this, floating rate funds end up simulating a varying rate by "laddering" their investments across timelines, and this affects the returns of the funds.

Types of Mutual Funds include the following:

- Equity Linked Savings Scheme
- Arbitrage Funds
- Dynamic Funds
- Fixed Maturity Plans
- International Mutual Funds
- Monthly Income Plans
- Multi Cap Funds
- Quant Funds

**REAL ESTATE**

- Guidance on Purchase of Property
  - Planning and Budgeting
  - Research
  - Home Loan
  - Safety points in the Home Agreement
  - Home Insurance
- Real Estate Investment Includes
  - Agricultural Land
  - Farm Houses
  - Urban Land
  - House Property
  - Commercial Property
- Real Estate Investment Options in India
  - Investment in Real Estate Stocks
  - Investment in Property

**Unique Characteristics of Real Estate**

- Durability
- Heterogeneous
- High transaction costs
- Long time delays
- Both an investment good and consumption good
- Immobility

**Characteristics of Real Estate as an Investment**

Real estate has a combination of characteristics that are not available through other asset classes, thus making it somewhat unique as an asset class.

1. ***Protection against inflation***: An investment property can offer the buyer a good protection against inflation. In this regard it is like Gold, in that usually real estate retains its intrinsic value. However, unlike Gold, one can earn income through real estate through rental income. Depending upon the existing price level in the economy, one can increase the rents in times of high inflation thus retaining the purchasing power of one's rental income. In addition, real estate offers the prospects of capital appreciation as well.
2. ***Tax incentives***: All around the world, different countries offer different incentives to buy real estate. For instance, it's very common for governments to offer some kind of tax subsidy for a property purchased for residential use (whether by self or let out). In some countries there are tax advantaged trusts through which investors can own real estate (REITs), and these are expected to emerge in India as well.
3. ***Diversification:*** There are many different categories of real estate investments. The most commonly understood in India is residential, but other types that are also growing are commercial (office buildings), retail (malls and shops), industrial (factories and warehouses) and lodging (hotels). Each of these has different drivers and different return characteristics.
4. ***Maintenance costs:*** Finally, if you have invested in any of the above type of properties, it is likely that you will have annual maintenance costs (cleaning, painting, ongoing repairs) and the occasional capital expenditure to upgrade the property every

few years. Investments such as stocks and FDs don't have these associated expenses.

## 2. Investment Related Issues

When it comes to the process of making a real estate investment and exiting from it, there are a few things that you must keep in mind.

1. ***Transaction costs***: When you buy or sell property, there are many associated costs associated: brokerage fees, stamp duty, registration fees, tax liability in case of gains. All these costs can add a material amount to the purchase or sale price of your investment.
2. ***Liquidity***: Some investments like stocks or FDs can be readily converted into cash in hand. Real estate on the other hand is not "liquid", i.e., it takes time to convert it into cash. If you need to have easy access to your money, please be aware that real estate deals take weeks or months to complete.
3. ***Cash:*** Property investments are not always the cleanest because of the cash versus cheque component of real estate deals. Unlike mutual funds where KYC norms require that the investment be made in cheque and the PAN card details be shared, real estate investments can have a huge cash (undeclared money) component to them. This might not suit everyone.
4. ***Long term Investment***: The preferable time horizon for real estate is four- seven years for it to deliver best returns. The low liquidity results in poor prices in case of distress sales. E.g. during the last downturn people had to sell their properties at throw away prices as they were unable to pay their EMIs. Hence, invest only long term surpluses and where you do not require liquidity.
5. ***Cyclical***: Real estate is also cyclical, though the cycles are significantly longer than equity cycles. If timing is wrong, it can also lead to losses or poor returns.

## 3. Frequently Asked Questions on Real Estate Investment

### What is Real estate investment?

Real Estate investment includes investment in

- Agricultural land
- Farm houses

- Urban land and
- House property
- Commercial property

**What are the guidelines used to evaluate real estate as an investment option?**

To evaluate real estate as an investment option, use the following guidelines.

- Check out the various loan options to raise the finances.
- Ensure that there is scope for infrastructure development around the property under consideration.
- Another factor is the location and the proximity to schools, hospitals, markets, public transportation, etc.
- Check out the rental returns and capital appreciation potential in the area where the property is located.
- Actual property taxes to be paid.
- Finally, ensure that you are able to maximize the tax benefits to the limit.

**What are the sources of Housing finance?**

- Own money
- State Housing Boards
- Loans from Employers
- Loans from Co-operative Housing Societies
- HDFC
- Housing Schemes of Banks and financial institutions
- LIC Housing Finance

**Who is liable to pay Stamp Duty - the buyer or the seller?**

The liability of paying stamp duty is that of the buyer unless there is an agreement to the contrary.

**In whose name are the stamps required to be purchased?**

The stamps are required to be purchased in the name of any one of the executors to the Instrument.

**What is meant by the market value of the property and is Stamp Duty payable on the market value of the property or on consideration as stated in the agreement?**

Market value means the price at which a property could be bought in the open market on the date of execution of such instrument. The Stamp Duty is payable on the agreement value of the property or the market value whichever is higher.

**Which are the instruments that attract the payment of Stamp Duty?**

The instruments like Agreement to Sell, Conveyance Deed, Exchange of property, Gift Deed, Partition Deed, Power of Attorney, settlement and Deed and Transfer of lease attract Stamp Duty on market value of the property.

**Who is the appropriate authority for knowing the market value of the property?**

The Sub-Registrar of the area, in whose jurisdiction the property is located, is the appropriate authority for knowing the market value of the property.

**What are the risks associated in buying a flat on Power of Attorney (POA) basis?**

Purchasing a flat on a POA basis is not permitted under the law of the land.

**What exactly do we mean by a Freehold flat? What are the advantages and disadvantages, if any?**

A freehold property (plot or a flat) is one where there is a sole owner(s), ownership is full and unconditional (within the provisions of the laws of the land) and there is no lessor/lessee involved.

**How do you verify the authenticity of the various documents submitted by the seller of the house, particularly with regard to the possibility that the house has not been sold earlier to a third party (i.e. title deed is clean) ?**

Regarding authenticity of documents, again, you have to take the help of an advocate to verify.

**What are the legal formalities in gifting a property?**

Gift of an immovable property is considered as a 'transfer' under the provisions of the Transfer of Property Act and you have to have the transaction registered through a Gift Deed and pay stamp duty as per provisions of the relevant stamp act depending in which state the property is situated.

### 4. Real Estate Glossary

Like in the medical or legal professions, real estate also has its own vocabulary, much of which can be confusing to the lay person. Here is a glossary of most commonly used terms in the industry so that you are not handicapped when buying real estate in India.

***Built-up area***: The built-up area refers to the entire area of the floor including carpet area, walls, lobbies and corridors, atrium areas and basement. In Delhi, the lift areas and staircase areas are included in the built-up area. In Mumbai, the basement, staircase, lift, and utility rooms like generator and electricity rooms are also taken as built-up area. In Bangalore, the basement is not included in the built up area and in Chennai, the basement and atrium areas are excluded. As always, check with your builder/broker on what definition they are using.

***Carpet area***: It is the actual usable area within the walls of the floor.

***Super (build-up) area***: This generally refers to the entire area of the building including carpet area, walls, lobbies and corridors, lifts, staircases basements, and other atrium and utility areas. In Delhi, the basement is not included in super area unless it is being used for commercial purposes. In Mumbai, the area under water tanks and other utility rooms are included in the super areas. In Chennai, the basement and atrium areas are included in the super areas whereas in Bangalore, the basement is not included in the super area.

***Efficiency ratio***: Efficiency ratio is generally expressed as a percentage of carpet to super areas of the property.

***Floor Space Index (FSI)***: Floor space index is the quotient of the ratio of the combined gross floor area of all floors excepting areas specifically exempted under these regulations to the total area of the plot.

***Maintenance charges***: These are charges taken by the maintenance society towards the maintenance of the property which includes costs of generator sets, security, landscaping, and common areas.

***Market value***: Valuation process evaluates the market value of the property. Demand and supply forces in the market and factors like type of property, quality and construction, its location, infrastructure and available maintenance are taken into consideration. Market value of the property is the price that the property commands in the open market.

***Stamp duty***: Real Estate Stamp duty is a type of tax collected by the Government of India. Stamp duty is based on the market value or the agreement value whichever is greater.

***Sale deed:*** The sale deed gives the buyer the absolute and undisputed ownership of the property. By executing this, the seller transfers his right of property to the buyer. It is executed subsequent to the execution of the sale agreement and after compliance of various terms and conditions detailed in the agreement.

***Registration charges***: These are the fees associated with getting the legal title registered in your name. This legal activity is conducted in the sub-registrar's office in your local court.

In addition to the above, the following terms are commonly used in the commercial real estate market and worth getting familiar with if you are considering buying commercial property.

***Common Area Maintenance (CAM):*** Common areas include hallways, pathways and utilities. CAM fees are collected by the landlords from the tenants to cover maintenance, property taxes and insurance in the case of Triple Net Lease.

***Cap rate***: This refers to the capitalisation rate. The capitalisation rate is the return on investment on the property. Capitalisation rate is measured by the formula: Purchase Price/Net Operating Income from the Property.

***Cash on cash:*** It is the annual percentage return of your down payment not including appreciation. It is the first year's cash flow divided by your initial down payment.

***CPI***: The Consumer Price Index is used to calculate the annual rental increase so as to compensate for inflation.

***Full service lease:*** This is a lease where the tenant pays rent to cover everything including utilities.

***Gross lease***: This is a lease where the tenant only pays the rent and the landlord pays the taxes, insurance and maintenance.

***Gross Leasable Area (GLA)***: This is the Gross Leasable Area or the total rentable area. This is the area that can be leased out for rental income. This does not include spaces for elevators, utilities room etc.

***Letter of Intent (LOI):*** This is the Letter Of Intent which is a non-binding offer letter to buy a commercial property.

***Mixed use***: These are commercial properties with retail on the first floor and apartments on upper floors.

***Net Operating Income (NOI)***: Net Operating Income is the annual income after deducting expenses like property tax, insurance, and maintenance but except mortgage payments.

***Percentage lease:*** It is a lease where the tenant pays base rent plus a percentage of the tenant's revenue.

If there is any real estate term that you are unsure of always check and verify. It is always better to ensure that you and the other party are working on the same understanding.

**Home Buying Tips from Start to Finish**

- **Identifying Your Needs**
  - Independent House or Apartment
  - Budget
  - Number of rooms and bathrooms
  - Approximate Area
  - Proximity to work place, school etc.
  - Parking availability
  - Water supply, power back up etc.
  - Furnished/unfurnished
  - Connectivity
  - Vicinity to market
  - Special amenities such as club house, pools or spas
  - Available utilities such as cable or DSL, satellite
  - Sewer, cesspool or septic connections
- **Finance**
  - Own funds
  - Loan from Banks/HFCs
  - Funds from your employer

   - Loan against assets
   - Provident Fund Loan
- **Scouting for property**
   - Brokers
   - Newspapers
   - Websites
   - Word of mouth
- **Cost Estimate**
   - Purchase Price
   - Stamp duty
   - Registration charges
   - Khata transfer charges
   - Utility Deposits like Water connection deposit, Electricity connection deposit, etc.
   - Other incidental expenses
- **Talk to Banks/HFCs**
   - Loan Amount
   - Loan Eligibility
   - Terms and conditions of loan
   - Interest Rate
   - Borrowing costs like processing fee, commitment charges, prepayment penalty, etc.
   - Loan tenures and EMI
   - Time taken for sanctioning the loan
   - Time taken for disbursing the loan
   - Freebies and corporate offers
- **Short listing Properties**
   - Site or property visit
   - Speaking to the neighbors or occupants

- Clear marketable titles
- Credibility of the seller
- Quality of the construction
- Legal verification
- Monthly payouts like maintenance charges, society charges, etc.
- Municipal taxes or property taxes

- **Finalising the Deal**
  - Negotiate on price and timing of payments (upfront/ installments)
  - Press for price negotiation if there are any modifications / repairs/painting to be done
  - Do not forget to collect all original property documents from the seller
  - Before paying the seller, make sure he has fulfilled all his commitments and promises
  - If the transaction involves a broker, withhold some amount of money until he delivers as promised

- **Documents required when the property is purchased from a builder**
  - An allotment letter from the developer on paying the booking amount
  - Agreement for Sale

- **Documents required to be checked if you are buying a resale flat**
  - *For flats being purchased in a registered co-operative society*
  - *For flats being purchased in an unregistered society or flats originally allotted by a Development Authority*

- **Check the credentials of your new property**
  - Invitation of Claims
  - Search at the Sub-Registrar's Office

- Enquiry at Municipal Corporation
- Enquiry with the Ward office
- If the owner of the property is deceased

- **Property Documents to be collected from the Seller**
  - *In case of a direct purchase from a builder*
    1. Copy of Agreement for Sale
       1. Copy of Registration Receipt
       2. Copies of receipts of payment already made
       3. NOC from builders
  - *In case of direct allotment in a Co-operative Housing Society*
    1. Allotment letter
    2. Share certificate
    3. Society registration certificate
    4. Copy of sale/lease deed in favour of the society
    5. NOC from society
  - *In case of direct allotment in a Co-operative Housing Society by Public Agency*
    1. Allotment letter, Share certificate, Society Registration certificate.
    2. Lease Agreement
    3. Public agency's approved list of members.
    4. NOC from Public Agency in favour of bank/HFC
    5. NOC from society
  - *In case of Public Agency's allotment to individuals*
    1. Allotment letter from Public Agency
    2. Tripartite Agreement between the borrower, Bank/HFC and the Public Agency in the prescribed format
  - *In case of resale*
    1. Copy of all previous vendors' registered documents along with copy of your purchase agreement duly

stamped and registered and the registration receipt wherever applicable.

- **Purchase of rentable properties**
  - Location
  - Numbers
  - High home prices
  - Low maintenance buildings
  - Ask to see the rental history
  - Owner/Manager out of the country
- **A Buyer's/Tenant's Checklist**
  - *Check if Use of Property would amount to Change of Land Use*
  - *Check if Non Residential Activity in Residential Premises Is Permissible*
  - *Check if the Municipal Guidelines allow Mixed Use*
  - *Ascertain if Professional Activity permissible in Residential Areas*
  - *Check if the Building adheres to the Sanctioned Plan*

**ALTERNATIVE INVESTMENTS**

An alternative investment is an investment product other than the traditional investments of stocks, bonds, cash, or property. The term is a relatively loose one and includes tangible assets such as art, wine, antiques, coins, or stamps and some financial assets such as private equity and film production. Globally, alternative investment avenues are quite in vogue among rich investors, who are estimated to allocate 5-10% of their investment portfolio into these products. Alternative investments are favoured mainly because their returns have a low correlation with those of standard asset classes.

In order to safeguard investors from falling prey to dubious schemes of portfolio managers, capital market regulator SEBI has come out with guidelines for alternative investments termed as the SECURITIES AND EXCHANGE BOARD OF INDIA (ALTERNATIVE INVESTMENT FUNDS) REGULATIONS, 2012 through a SEBI Notification dated 21st May 2012. It aims to frame a stringent set of rules for funds investing in art works, antiques, coins and stamps, with an aim to check black money flow into these products and safeguard the interest of genuine investors.

Globally, art funds are very famous as alternative class of investments for rich investors and have started gaining ground in India over the past few years. However, there are no specific rules in India for art and other such funds, which collect money from numerous investors, mostly high-net worth individuals, to invest in art works, antique pieces as also old and rare coins and stamps.

**The following options are available**

– Rare Coins and Paper Currency
– Stamp Collection
– Art
– Antiquities
– Wine
– Private Equity
  • Venture Capital
  • Replacement Capital
  • Buyout
  • Special Situation
  • Risk of investment through PE
  • Role of Stock Market

## 1. Rare Coins and Paper Currency (Numismatics)

Numismatics is the study or collection of currency, including coins, tokens, paper money, and related objects. With a bit of interest and insight into the art of collecting coins and paper money, one can expect handsome returns comparable to traditional investments. The idea of numismatics as an investment tool is still in its nascent stage but is fast catching up in India.

### *a. The Numismatics Market*

Contrary to the popular perception, one need not be a high net-worth individual to enter the numismatics market. Price of commemorative coin sets starts at around ₹ 2,000-3,000, which even a middleclass salaried person can easily afford. On the other hand, some rare British-India 'gold-mohurs', can be as expensive as ₹ 4 to 5 lakhs each. So, there is plenty of opportunity for people looking at exotic investment options as well. If you have chosen to invest in ancient coins which are mostly in either of silver, gold or copper, you are sure to get a price for the precious metal at least in case you are in a hurry to liquidate.

Commemorative coins are available in two varieties — proof and uncirculated. Proof coins are specially made coins of the highest quality, having first-rate mirror finish contrasting with frosting on the relief (the raised portion in a coin), and are therefore of higher value. Also, the commemorative coins which have been issued by the government so far have various denominations ranging from 5 paisa to ₹ 100. Error coins, coins with flaws that occurred in the minting process, fall under the rare category and thus can fetch much higher prices. Since there are many coins minted in each era, it is impossible to collect all of them.

A collector should concentrate on one particular era, theme or subject such as Republic India, British India, princely states, Mughal sultanates, ancient coins, etc. to begin. Joining a numismatic society and being in this circuit can help in gaining knowledge on the subject.

Auction houses or coin dealers may not be the best place to start buying your collection. For the beginners, the best place to buy commemorative coins would be directly from Government owned mints. Mints at Mumbai and Kolkata sell commemorative coins. Whenever a new commemorative coin is issued, the mints offer bookings to the public.

One can book online or send a demand draft to these mints. The coins are usually delivered six to 12 months after booking. If someone misses this direct booking opportunity, they can go online and buy through portals like eBay.

### *b. Fitness Check*

One must not just buy coins on impulse. Try to read about them as much as possible before you take a plunge. Two coins may look exactly the same to you but a minor variation could mean a huge difference in their value. Beware that there are many fakes floating in the market. It will be wise to know all attributes of the coin such as weight, diameter, metal composition, year of issue, mint etc., before you actually buy it. Also beware of sellers using adjectives like 'rarest', 'super rare', 'extraordinary' etc. to sell these items.

Since the Indian numismatics market is not regulated, it is recommended that you buy coins and paper currency only from reputed dealers and auction houses who give guarantee on the authenticity.

### c. *Investment Strategy*

Coins and bank notes can be ideal investments to diversify your portfolio. As more collectors are getting interested and the supply is comparatively less, it can be a very good investment channel for investors who are looking for long term gains. Since these are rare items and can't be reproduced, the value will only increase with the rise in demand. But those looking for high returns in the short-term, should avoid putting their money in coins.

An investment in a single rare item is better as chances of appreciation in its value are much higher, but you will need to make a sizeable investment to buy one. One can consult catalogues like the Standard Catalogue of World Coins for getting an idea of the price of a coin. However, these are published annually, so the weekly or monthly price fluctuations would not be available. The price of a coin typically would depend on its rarity, condition and series and are chiefly governed by demand and supply. Coins with low mintage numbers will always be costlier. Abroad, weightage is also given to the quality or grade of the coins.

Just as one approaches portfolio managers to get best returns from stock and bonds, one should consult an adviser with knowledge on the subject for returns from coins as well. Some auction houses and coin dealers can also provide valuation of the coins for a small fee. However with very few professionals in this field, this is yet to pick up in India.

### d. *Preserving Your Investment*

Knowing how to preserve a coin is important. Some common guidelines:

1. Handle coins only from the edges;
2. Do not touch the obverse or reverse;
3. Try to keep them in their original form;

4. Never clean a make them coin to look new or add fake lustre;
5. Do not fold or laminate a paper currency.
6. Consult an expert for specific methods of preserving rare items.

Though the number of investors has been growing rapidly in the past few years, compared to the numismatics trade in the western countries or other popular alternative investment channels such as fine arts, wine, etc., the volume of trade in coins is still low. One of the major reasons is lack of awareness.

**2. Stamp Collection (Philately)**

Investing in stamps can help you earn handsome returns in the long term. The demand for Indian stamps has been rising from the past two-three years. So, it might be the right time to park some funds here before prices go beyond your reach.

***a. Investment Performance***

It is difficult to predict how a stamp will perform in future. Stamps tend not to move in a linear fashion, but in 'steps', driven by the market movements. Therefore, it is advised to have a minimum five year holding before looking for gains.

The best available indicator of the rare stamp market is the Stanley Gibbons GB30 Rarities Index (listed on Bloomberg Professional), which tracks the prices of 30 classic British stamps recommended for investment. It has shown a compounded annual growth of 10% over the last 50 years and has never fallen during that time.

Compared with developed nation like Europe and US, where investment in stamps is a recognised and well-organised channel of investment, the Indian market is still in its nascent stages. Since the percentage of people who look at it as an alternative investment channel is pretty small, the demand, and therefore value, of Indian stamps is also comparatively low.

***b. Investment Strategy***

Like any other investment, knowledge is the key to succeed in putting together a collection that would give decent financial returns in future. Apart from theoretical awareness, it is also important that you have a genuine interest in stamps.

In India, you would not find professionals to manage your portfolio. Get in touch with local philatelists who can guide you in making a collection as per your interest. Finding stamp enthusiasts outside India and making them your pen friends is another old but popular way to start.

While definitive stamps are used for regular mailing purposes, it is commemorative stamps which collectors generally put their money in. These stamps are printed in limited quantities and one can buy them from the Philatelic Bureaux and its counters.

Stamps can be collected on the basis of time periods (year-wise), countries they belong to or according to a particular theme such as flowers, birds, monuments, armed forces stamps, etc. To make it easier and attractive, many philatelists, who take it as an investment option, would advice you to have a thematic collection.

To get the best deals, it is important that you build your collection over time. Spend time hunting through stamp pages, albums, network with all kinds of stamp dealers and collectors, attend philatelic society meetings and events and you will definitely find the best deals to complete a collection at a smaller price.

Also, it is important that you build a balanced portfolio. Don't put all your funds in one stamp or of a single type. If you have a portfolio of rare stamps, hold it on to it for a few years to maximise the returns as trading volumes are low in case of rare items.

### *c. Pricing of Stamps*

A rough estimate of the market value of a stamp can be had by using a price catalogue such as the annual Indian publication from Kolkata, *Phila India* or you can go to *Allworldstamps.com*, an online stamp catalogue to search details of stamps from various countries all over the world. You can even find information about different dealers here. These price catalogues come in a variety of formats from simplified to specialise.

Although a catalogue will give you an idea of the price, it is not adequate for assessing whether a stamp is of investment grade or not. The rule of demand and supply applies to the stamp market as well.

The condition of the stamp also plays a vital role in its valuation. Even though catalogues specifically mention that the price quotes are for stamps in 'fine' condition, many make the mistake of pricing them strictly on the basis of this document. If you find a stamp in better than 'fine' condition, you might have to pay a higher price, while the price for a similar stamp in poor condition will be substantially lower.

Every single feature of a stamp needs to be considered separately before a judgment on its value can be passed. However, there are some consistent factors such as the condition of the gum, colour of the stamp, margins, perforation and the quality of cancellation, which fall under essential considerations before its value can be estimated. Ultimately, rarity and number of examples available will have the biggest bearing on the price.

A subtle difference in colour could mean you have a rare 'error of colour' thus elevating an ordinary stamp to something extraordinary or it could be just a poor quality faded stamp which is actually of lower value. Also, many flaws are not visible to the naked eye and certain characteristics such as the quality of the cancellation can only be judged by an expert who has vast experience in handling stamps. You should take an expert's opinion before you make any expensive purchase.

### 3. Art

Investing in art is a good method for diversification. Since art prices do not depend on other possible components of a portfolio, they act as a cushion when other markets are not doing well. The aesthetic pleasure of viewing a great piece of art is a great advantage.

A few things an investor must look into:

- Art buyers should gain as much knowledge as possible of the artist's work, the quality, provenance, condition and period in which it was painted before investing.
- Have a clear idea about the time horizon and gestation period for a particular work to appreciate in value.
- If an investor is looking for quick returns, he must buy works of well-known artists. If you like a less famous artist's work and are prepared to wait, your returns might grow majorly over a period of time.

- Buy art only if you like the quality of work and not just the artist. Art requires careful maintenance.

### *a. Risks of investing in Art*

Like all other investments, investing in art also has its downsides. Not anyone can invest in art. It requires a certain level of knowledge and expertise. The fact that they depend largely on public tastes and other factors, make art objects a fairly speculative investment.

If you suddenly need to sell the masterpiece that you happen to own, it will become apparent that the art market is not transparent because no two people agree on what the appropriate valuation is. Moreover, it is an illiquid asset.

The Indian art market is especially shallow, with relatively few buyers. Furthermore, high transaction costs can swallow as much as 30% of the sale price (at auctions), compared to selling stocks for a few pennies. And, all of this is before accounting for the fact that unlike property, stocks and bonds, there is no underlying income stream such as rentals, dividends or interest received whilst owning the masterpiece. On top of that, the owner usually has to pay storage and insurance costs.

### *b. Taking Care of Your Art*

When you buy an art object, you invest a significant sum of your money in these objects. This value will however not sustain and definitely not appreciate unless you look after the works and prevent damage caused by nature or carelessness.

It is very important to get advice from professionals on how to maintain your works well. Some tips are:

- Always keep minimum light around your paintings and display your most valued artworks in areas that receive less direct or prolonged light.
- Do not hang your paintings next to direct heat or moisture sources, outdoor vents, damp walls, unventilated rooms, air conditioners, coolers or fireplaces.
- Use two pegs to hang the painting and secure it well. Make sure heavy paintings are supported at the base.

- Check your works regularly and if you see any fungus growth (green, white or grey fluffy spots) over a work, glass over the work, spray glass cleaner onto a cloth and wipe it. Separate them from other paintings so that the fungus does not spread. Immediately take it to a professional restorer.
- If the polythene sheet over a painting or paper work gets stuck, do not remove it. Leave it to an expert.

### *c. The Sound Portfolio*

It is advisable to have a portfolio with both modern and contemporary works as each has its strength and potential. The former illustrates our nation's history and will continue to appreciate due to this significance, while the latter represents the culture of our times.

It is advised that an art portfolio should consist mostly of moderns. Their works have surpassed the market movements and sustained their value. Invest a smaller percentage on contemporaries because a lot of them have shown erratic movements in terms of pricing and many have not been able to sustain their quality. Focus on those whose prices have not been unnaturally volatile.

It is imperative to buy from reputed galleries as they promote and nurture an artist's career. Explore the artist's international presence because it represents the future promise.

Most importantly, if you invest in high quality art that you connect with, you are likely to spot the best works.

## 4. Antiquities

Antiquities are the story tellers of the history of the world. Their importance lies in their dwindling numbers and their reflection of the culture of bygone societies. A historical object of significance will only get rarer with time, and as the rule goes, the rarer the object, the more valuable it is.

The antiquities market consists of small collectibles (like vessels, lamps, prints and puppets, etc.), wooden carvings and textiles, stone sculptures, bronze works and miniature paintings in a more or less ascending order. Most of the pieces acquired range from the 10th to 19th century.

Miniatures constitute the top end, requiring expert knowledge and understanding. Stones and bronzes range from various dynasties. Wood carvings, textiles and pichwais usually range from the 17th to 20th century. Although not a thumb rule, most antiquities sell in India for barely 1/3rd the international price. Small exceptions to this rule are the Tanjore and Mysore paintings, which sell at a higher price in India than overseas. It is this price differential, coupled with a boom overseas, that is set to drive prices in India.

***a. Investment Strategy***

Antiquities have a very strong foundation because these are finite objects. Even when the market is dull, their prices do not fall. However, one needs to do a lot of research because only then will you acquire something investment worthy. This can be exhausting but there is no other way.

***b. Indian Antiquities***

With a rich history, India brims with antiquated objects. However, laws prohibit the export of Indian antiquities, specifically sculptures and paintings.

Over the past few years, Indian antiquities within the country have appreciated at 40 percent every year. There are only 10 to 15 registered dealers in the country so it is a task to find well- documented antiquities. You can buy from unregistered dealers but the perils with this are the lack of information on the origin — which could devalue it — and the possibility of fakes. When you do buy from official dealers, the antiquities are already registered with the Archaeological Survey of India (ASI). You just need to submit a 'Transfer of Ownership' form to the ASI within 10 days of the transfer.

Even if you move the object to a different location, you need to inform the ASI officer in your area. This is only a notification, but could be considered an additional hassle.

*Selling*: You should keep antiquities bought in India for at least five years for them to appreciate enough. You can sell all kinds of antiquities through registered dealers or auction houses.

***c. Indian antiquities from Abroad***

When you purchase Indian antiquities overseas to bring them back, be aware of a couple of things.

You could also have problems while importing. Sometimes it is not as simple as just paying the 15 per cent duty. Customs officials might suspect that you have undervalued it and that could lead to dispute. When the object does pass customs, you need to submit a registration form to the ASI. An officer usually comes to inspect that the item matches the details.

*Selling*: If you import Indian antiquities, hold it for a minimum of 10 years to get a good price within the country. If you keep it abroad (a better option), you could sell it sooner.

### *d. International Antiquities*

You could purchase a variety of priceless antiquities from ancient civilisations like China, Mesopotamia, the Middle East etc. at auctions or from dealers like Art Ancient in the UK.

The value of many of these is astonishing. On November 11, 2010, a Chinese vase from the Qing Dynasty (1740) sold at Bainbridges in London for $83 million. If you purchase an object like this and bring it to India, you would need to pay the duty and may have trouble at customs, but you can always export the work again to sell. This is a great benefit in investing in non-Indian antiquities.

*Selling*: These can be sold after a couple of years, depending on the appreciation of that piece.

## 5. Wine

At an annual traded value of $4 billion (year-on-year), wine is emerging as a very good investment option. The London-based Liv-ex Fine Wine 100 Index, the wine investment industry benchmark, has been giving a compounded annual return of 13.7 per cent since 1988. As of November 2010, the Liv-ex gave a return of 38.7 per cent year-on-year.

For instance, the price of Château Lafite Rothschild, 2000 vintage, has risen more than five times over the last five years. Château Mouton Rothschild, 1982 vintage, has shot up 173 per cent in the same period.

As of now, there are no Indian wines, wineries or wine funds one can invest in. Investors have to look to international wine funds. However, internationally too, not every wine is worth investing in. In practice, this is a narrow group of wines considered as investment grade internationally and includes the very top wines of the Bordeaux region in France and a smattering of wines from Burgundy, the Rhone, Italy, Champagne and the New World [California].

Wine purchased as an investment is typically obtained from a reputable wine broker since wine houses do not generally sell directly to the public. Indian wine advisory firms, such as Antique Wine Company and Drayton Capital, offer services to hold and preserve the wine on behalf of their clients.

***a. Advantages***

Firstly, being a physical commodity, it is not affected by the stock market, company bankruptcies, fraudulent activities, major market shifts or even poor management. Wine Investment provides legitimate ways of exemption from capital gains tax, VAT and import and export duties. Like other tangible investments, wine provides a good means to diversify a portfolio. Fine Wine increases in quality with time, hence its value continually increases.

***b. Disadvantages***

It is argued that Wine Investment Market is difficult to understand and analyse. Wines are not always priced based on their value, but on the basis of their demand, which in turn is dependent on several unstable factors. In order to store and preserve wines, investors tend to incur sizeable expenses. Also if you are importing wine, exchange rate risk also come to the picture. It is strictly for people who know and understand wine.

***c. Investment Strategy***

If you have met your targeted investments in debt, equity, and property, you can consider buying a couple of bottles or investing in a wine fund. The minimum investment should be around ₹ 2 lakh. But before that, one should brush up their wine knowledge. As with all other investments, you must do rigorous research about terroir, storage conditions and the pedigree of wine producers to make an informed choice.

Here are three popular ways to invest in wine:

*Buy bottles:* It is the most traditional and seemingly simple way to invest in wine. But buying bottles is not easy as wine trading is still a new concept in India. A thorough examination of the brand, vintage, longevity, history of the producer, consistency, score and storage conditions is essential to determine the quality of the wine. Online ratings by reputed societies and wine tasters are a reliable source for such information. To buy the wine, you have to rely on brokers in other countries who export it to India. This increases the cost of investment as you have to pay import duty. Then comes the headache of finding a suitable warehouse to store the bottles for several years.

The solution is to keep them in bonded warehouses in the countries you buy them. You will have to pay storage charges but these are lower than the import duty. The brokers will monitor the investments and also help you to sell them. Taxes will kick in where applicable.

*Wine Funds*: AAs with gold and art, you can invest in wine through specialty funds that buy wine. The funds send a share certificate with details of your investment, including a net asset value of the share. They also give regular updates on the value of your wine. The minimum lock-in period varies across funds. At the time of exit, you receive the net profit depending on the growth in the value of the wine.

The advantage of wine funds is that you don't have to worry about storage or broker commissions. However, a high entry fee could be a barrier for most investors. The minimum amount for investing through funds or advisory companies is more than ₹ 1 lakh.

*Wine Futures*: If you want to invest in wine even before it is bottled, opt for wine futures, also called wine primeurs. Investing in wine that has not been tasted is considered riskier than buying bottles or buying wine funds.

Only 1% of the world's wines (268.7 million hectolitres) are investible. These wines can last between 50 and 100 years. The value of all wines does not appreciate with maturity, so wines with a shorter lifespan may not make for good investments. Wine is a long-term investment. Profits can range from 10-50% on every bottle, but the key is to remain invested for a long time. The investment horizon for wines to mature is 5-15 years.

### 6. Private Equity

Private equity has arrived as a major component of the alternative investment universe and is now broadly accepted as an established asset class within many institutional portfolios. Many investors with little or no existing allocation to private equity are now considering establishing or significantly expanding their private equity programs.

Private equity investing may broadly be defined as "investing in securities through a negotiated process". The majority of private equity investments are in unquoted companies. Private equity investment is typically a transformational, value-added, active investment strategy. It calls for a specialized skill set which is a key due diligence area for investors' assessment of a manager. The processes of buyout and venture investing call for different application of these skills as they focus on different stages of the life cycle of a company.

Private equity investing is often divided into the categories described below. Each has its own sub-categories and dynamics and whilst this is simplistic, it provides a useful basis for portfolio construction. Private equity is the universe of all venture and buyout investing, whether such investments are made through funds, funds of funds or secondary investments.

***(1) Venture Capital***

Venture capital is investing in companies that have undeveloped or developing products or revenue.

- *Seed stage*: Financing provided to research, assess and develop an initial concept before a business has reached the start-up phase.
- *Start-up stage*: Financing for product development and initial marketing. Companies may be in the process of being set up or may have been in business for a short time, but have not sold their products commercially and are not yet generating a profit.
- *Expansion stage*: Financing for growth and expansion of a company which is breaking even or trading profitably. Capital may be used to finance increased production capacity, market or product development, and/or to provide additional working capital. This stage includes bridge financing and rescue or turnaround investments.

***(2) Replacement Capital***

Purchase of shares from another investor or to reduce gearing via the refinancing of debt.

***(3) Buyout***

A buyout fund typically targets the acquisition of a significant portion or majority control of businesses which normally entails a change of ownership. Buyout funds usually invest in more mature companies with established business plans to finance expansions, consolidations, turnarounds and sales, or spinouts of divisions or subsidiaries. Financing expansion through multiple acquisitions is often referred to as a "buy and build" strategy. Investment styles can vary widely, ranging from growth to value and early to late stage. Furthermore, buyout funds may take either an active or a passive management role.

***(4) Special Situation***

Special situation investing ranges more broadly, including distressed debt, equity-linked debt, project finance, one-time opportunities resulting from changing industry trends or government regulations, and leasing. This category includes investment in subordinated debt, sometimes referred to as mezzanine debt financing, where the debt-holder seeks equity appreciation via such conversion features as rights, warrants or options.

Go for this option only if you have a large sum — say a crore of rupees — which you can invest and wait at least eight years before you see any money back.

Through a PE fund, you can invest in upcoming companies in new sectors. Taking a relatively early position in them can fetch very good returns. Very often such companies are in the pre-IPO stage, and need both financial and managerial support, which is provided by the PE fund, and can give higher return than other asset classes.

One can also choose funds that are specialists and invest in sectors where public stock markets don't offer many options.

About 10 per cent of the total portfolio in PE would be ideal for diversification purpose.

***(5) Risk of investment through PE***

This is a highly illiquid piece of investment. Since PE funds invest in unlisted companies, it is hard to sell that investment in a jiffy, should the need arise. You may not see any returns for the next decade. There is less flexibility to exit and hence needs patient investment.

Investing in a PE fund with managers that have a very strong track record is critical, since investors really have no influence on the companies that are being invested in. The fund managers should have seen at least two business cycles. This means the team should have stuck around for at least 10 years. One of the key problems with not having experienced managers is valuation goof-up. This is very important today because high levels in the public stock markets are driving valuations steeply in unlisted markets.

If you make an entry at the wrong price in an unlisted company, you are doomed. It is impossible to average it down and make any decent money off it later. But if you must take this decision, choose a fund that does not invest in very small companies. Choose PE funds that invest in a combination of pre-IPO and public companies. It increases the probability of steady exits and hence returns to the investors.

***(6) Role of Stock Market***

While the performance of private equity funds in markets is less correlated with public equities, functioning stock markets still play an important role. Private equity benefits from a liquid and well performing stock market, either as an exit route, a source of fund capital or, increasingly, as a source for deals.

***(7) Current Trends***

Close to $40 billion has been raised by India-focused funds since 2005 (excluding allocated capital from global funds to India); the industry has grown from a handful of institutional PE firms to over 300 or 500 firms. About $50 billion has been invested to date since 2004. Managers have been charging standard terms of two per cent management fee and 20 per cent carried interest. They have not been compromised in economics.

**The SEBI (Alternative Investment Fund) Regulations 2012 – An Overview**

a. All AIFs whether operating as Private Equity Funds, Real Estate Funds, Hedge Funds, etc. must register with SEBI under the AIF Regulations.

b. SEBI (Venture Capital Funds) Regulations, 1996 ("VCF Regulations") have been repealed. However, existing VCFs shall continue to be regulated by the VCF Regulations till the existing fund or scheme managed by the fund is wound up. Existing VCFs, however, shall not increase the targeted corpus of the fund or scheme as it stands on the day of Notification of these Regulations. Such VCFs may also seek re-registration under AIF regulations subject to approval of 66.67% of their investors by value.

c. Existing funds not registered under the VCF Regulations will not be allowed to float any new scheme without registration under AIF Regulations. However, schemes floated by such funds before coming into force of AIF Regulations, shall be allowed to continue to be governed till maturity by the contractual terms, except that no rollover/ extension or raising of any fresh funds shall be allowed.

d. Existing funds not registered under the VCF Regulations which seek registration but are not able to comply with all provisions of AIF Regulations may seek exemption from the Board from strict compliance with the AIF Regulations.

e. The first amendment to the SEBI (AIF) Regulations, 2012 was issued via a SEBI notification dated 16th September 2013. The following amendments have been carried out:

   i. Notified the framework for setting up Angel Funds.

   ii. Have cut lead time for fund managers for seeking commitments.

   iii. Linked the investment allocation for different categories of AIFs to their 'investible funds' (previously the linkage was to the 'corpus' of the fund).

   iv. Permits a lower threshold of ₹ 2.5 million in case a Social Venture Fund accepts grants as against the prescribed minimum ticket size of ₹ 10 million for capital commitments.

**Categories of funds**

The Regulation seeks to cover all types of funds broadly under 3 categories. An application can be made to SEBI for registration as an AIF under one of the following 3 categories:—

i. **Category-I AIF** – Those AIFs with positive spillover effects on the economy, for which certain incentives or concessions might be considered by SEBI or Government of India or other regulators in India; and which shall include Venture Capital Funds, SME Funds, Social Venture Funds, Infrastructure Funds and such other Alternative

Investment Funds as may be specified. These funds shall be close ended, shall not engage in leverage and shall follow investment restrictions as prescribed for each category. Investment restrictions for VCFs are similar to restrictions in the existing VCF Regulations.

ii. **Category-II AIF** – those AIFs for which no specific incentives or concessions are given by the government or any other Regulator; which shall not undertake leverage other than to meet day-to-day operational requirements as permitted in these Regulations; and which shall include Private Equity Funds, Debt Funds, Fund of Funds and such other funds that are not classified as category-I or III. These funds shall be close ended, shall not engage in leverage and have no other investment restrictions.

iii. **Category-III AIF** – those AIFs including hedge funds which trade with a view to make short term returns; which employs diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives. These funds can be open ended or close ended. Category-III funds shall be regulated through issuance of directions regarding areas such as operational standards, conduct of business rules, prudential requirements, and restrictions on redemption, conflict of interest as may be specified by the Board.

**Other salient features**

a. The Alternative Investment Fund shall not accept from an investor an investment of value less than rupees one crore. Further, the AIF shall have a minimum corpus of ₹ 20 crore.

b. The fund or any scheme of the fund shall not have more than 1000 investors.

c. The manager or sponsor for a Category-I and II AIF shall have a continuing interest in the AIF of not less than 2.5% of the initial corpus or ₹ 5 crore whichever is lower and such interest shall not be through the waiver of management fees.

d. For Category-III Alternative Investment Fund, the continuing interest shall be not less than 5% of the corpus or rupees ten crore, Whichever is lower.

e. Category-I and II AIFs shall be close-ended and shall have a minimum tenure of 3 years. However, Category-III AIF may either be close-ended or open-ended.

f. Schemes may be launched under an AIF subject to filing of information memorandum with the Board along with applicable fees.

g. Units of AIF may be listed on stock exchange subject to a minimum tradable lot of rupees one crore. However, AIF shall not Raise funds through Stock Exchange mechanism.

h. Category-I and II AIFs shall not be permitted to invest more than 25% of the investible funds in one Investee Company. Category-III AIFs shall invest not more than 10% of the corpus in one Investee Company.

i. AIF shall not invest in associates except with the approval of 75% of investors by value of their investment in the Alternative Investment Fund.

j. All AIFs shall have QIB status as per SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

k. The Regulations provide for transparency and disclosures and mechanism for avoidance of conflict of interest.

**No Difference in Governmental Regulations for Venture Capital and Private Equity**

There are no legal or regulatory differences between 'private equity funds' and 'venture capital funds', and the SEBI (Alternative Investment Fund) Regulations, 2012 (SEBI (Venture Capital Funds) Regulations 1996 stands repealed) and FVCI Regulations seek to regulate all PE or VC funds irrespective of such difference in their nomenclature. Consequently, trusts, companies and LLPs desirous of establishing a private equity fund are required to register themselves with the SEBI as 'venture capital funds' to undertake private equity and venture capital activities, irrespective of whether the investment is a significant investment or not.

**Legislations having a bearing on Private Equity**

The Legislations, which will have a bearing on the Private Equity Deal, are:

1. Capital Market Regulations • Securities and Exchange Board of India Act,1992 • SEBI (Issue of capital & Disclosure requirements) regulations 2009 - Chapter XIII- Guidelines for Preferential Issues - Chapter XIIIA- Guidelines for Qualified Institutions Placement • SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997 • SEBI (Prohibition

of Insider Trading ) Regulations 1992 • SEBI (Foreign Institutional Investors) Regulations 1995 • SEBI (Alternative Investment Fund) Regulations, 2012 (*SEBI (Venture Capital Funds) Regulations 1996 stands repealed*) • SEBI (Foreign Venture Capital Investors) Regulations 2000 • SEBI (Mutual Funds) Regulations 1996 • Securities Contracts (Regulation) Act,1956

2. Reserve Bank of India (RBI) • Foreign Exchange Management Act, 1999 • Foreign Exchange Management Regulations (Transfer or Issue of Security by a Person Resident Outside India Regulations 2000)

3. Foreign Investment Promotion Board (FIPB) • Foreign Direct Investment Policy • Investment Approvals • Press Notes

4. Income Tax Laws • Income Tax Act, 1961 • Double Taxation Avoidance Agreements • DTAA (Comprehensive agreements With respect to taxes on income) • DTAA (Limited agreements – With respect to income of airlines/merchant shipping)

5. Indian Accounting Standards and International Financial Reporting Standards (IFRS) • IAS 32- Financial Instruments: Presentation • IAS 39- Financial Instruments- Recognition and Measurement • IFRS 7 – Financial Instruments Disclosures

6. Other Laws: • Companies Act, 1956 (*Companies Act, 2013 has been passed by the Parliament on 8th of August 2013*) • Indian Trust Act, 1882 • Indian Contract Act, 1872 • Foreign Contribution (Regulation) Act, 2010 • Limited Liability Partnership Act 2008 • Listing agreement Clause 40A and 40B for Listed Companies • Section 81 and 81A of the Companies Act 1956 - A public company will have to comply with these sections • Unlisted Public Companies (Preferential Allotment) Rules, 2003. • Private Limited Company and Unlisted Public Limited Company (Buy Back of Securities) Rules 1999

**NON-RESIDENT INDIAN (NRI)**

India offers a tremendous opportunity for investment and wealth building for Non-Resident Indians (NRI) as India is slated to grow at the rate of 8%-10% for the next few decades. The Government has provided a wide range of incentives and concessions to Non-Resident-Indians, some of which are being listed here.

The residential status of a person is decided under two different Acts, one under Income Tax Act, 1961, (I.T. Act) and another under Foreign Exchange Management Act, 1999. The concept of Non-Resident under

FEMA is different as compared to that under Income Tax Act. Under Income Tax Act, the residential status of a person is determined on the basis of the number of days he stays in India whereas under FEMA, a person resident in India is defined as a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year (April-March) and who has come to or stays in India either for taking up employment, carrying on business or vocation in India or for any other purpose that would indicate his intention to stay in India for an uncertain period. In other words, to be treated as `a person resident in India' under FEMA, a person has not only to satisfy the condition of the period of stay (being more than 182 days during the course of the preceding financial year) but has also to comply with the condition of the purpose / intention of stay.

**Person of Indian Origin (PIO)**

'A Person of Indian Origin' means an individual (not being a citizen of Pakistan or Bangladesh or Sri Lanka or Afghanistan or China or Iran or Nepal or Bhutan) who

(1) at any time, held an Indian Passport, or

(2) who or either of whose father or mother or whose grandfather or grandmother was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955).

**Overseas Corporate Bodies (OCB)**

Overseas Corporate Bodies (OCBs) are bodies predominantly owned by individuals of Indian nationality or origin resident outside India and include overseas companies, partnership firms, societies and other corporate bodies which are owned, directly or indirectly, to the extent of at least 60% by individuals of Indian nationality or origin resident outside India as also overseas trusts in which at least 60% of the beneficial interest is irrevocably held by such persons. Such ownership interest should be actually held by them and not in the capacity as nominees, The various facilities granted to NRIs are also available, with certain exceptions, to OCBs so long as the ownership/beneficial interest held in them by NRIs continues to be at least 60%.

**Facilities available to NRIs/OCBs**

NRIs/OCBs are granted the following facilities:

1. Maintenance of bank accounts in India.
2. Investments in securities/shares of, and deposits with, Indian firms/companies.

3. Investments in immovable properties in India.

**Features of various Deposit Schemes available to NRIs**
*(Updated as of September 2013)*

| *S. No.* | *Particulars* | *Foreign Currency (Non-Resident) Account (Banks) Scheme [FCNR (B) Account]* | *Non-Resident (External) Rupee Account Scheme [NRE Account]* | *Non-Resident Ordinary Rupee Account Scheme [NRO Account]* |
|---|---|---|---|---|
| | *(1)* | *(2)* | *(3)* | *(4)* |
| 1 | **Who can open an account** | NRIs (individuals/ entities of Bangladesh/ Pakistan nationality/ ownership require prior approval of RBI) | NRIs (individuals/ entities of Bangladesh/ Pakistan nationality/ ownership require prior approval of RBI) | Any person resident outside India (other than a person resident in Nepal and Bhutan). Individuals/ entities of Pakistan nationality/ ownership, entities of Bangladesh[2] ownership and erstwhile Overseas Corporate Bodies[5] require prior approval of the Reserve Bank. |
| 2 | **Joint account** | In the names of two or more non-resident individuals provided all the account | In the names of two or more non-resident individuals provided all the account | May be held jointly with residents |

| S. No. | Particulars | Foreign Currency (Non-Resident) Account (Banks) Scheme [FCNR (B) Account] | Non-Resident (External) Rupee Account Scheme [NRE Account] | Non-Resident Ordinary Rupee Account Scheme [NRO Account] |
|---|---|---|---|---|
| | (1) | (2) | (3) | (4) |
| | | holders are persons of Indian nationality or origin;<br>Resident close relative (relative as defined in Section 6 of the Companies Act, 1956) on 'former or survivor' basis. The resident close relative shall be eligible to operate the account as a Power of Attorney holder in accordance with extant instructions during the life time of the NRI/ PIO account holder. | holders are persons of Indian nationality or origin;<br>Resident close relative (relative as defined in Section 6 of the Companies Act, 1956) on 'former or survivor' basis. The resident close relative shall be eligible to operate the account as a Power of Attorney holder in accordance with extant instructions during the life time of the NRI/ PIO account holder. | |
| **3** | **Nomination** | Permitted | Permitted | Permitted |

| *S. No.* | *Particulars* | *Foreign Currency (Non-Resident) Account (Banks) Scheme [FCNR (B) Account]* | *Non-Resident (External) Rupee Account Scheme [NRE Account]* | *Non-Resident Ordinary Rupee Account Scheme [NRO Account]* |
|---|---|---|---|---|
| | *(1)* | *(2)* | *(3)* | *(4)* |
| 4 | **Currency in which account is denominated** | Any permitted currency i.e. a foreign currency which is freely convertible | Indian Rupees | Indian Rupees |
| 5 | **Repatriablity** | Repatriable | Repatriable | Not repatriable except for the following:<br>i) current income<br>ii) up to USD 1 (one) million per financial year (April-March), for any bonafide purpose, out of the balances in the account, e.g., sale proceeds of assets in India acquired by way of purchase/ inheritance/ legacy inclusive of assets acquired out of settlement subject to certain conditions. |

| S. No. | Particulars | Foreign Currency (Non-Resident) Account (Banks) Scheme [FCNR (B) Account] | Non-Resident (External) Rupee Account Scheme [NRE Account] | Non-Resident Ordinary Rupee Account Scheme [NRO Account] |
|---|---|---|---|---|
| | (1) | (2) | (3) | (4) |
| | **Type of Account** | Term Deposit only | Savings, Current, Recurring, Fixed Deposit | Savings, Current, Recurring, Fixed Deposit |
| | **Period for fixed deposits** | For terms not less than 1 year and not more than 5 years. | At the discretion of the bank. | As applicable to resident accounts. |
| 6 | **Rate of Interest** | With effect from close of business in India as on August 14, 2013 (i) deposits of 1 year to less than 3 year maturity, interest shall be paid within the ceiling rate of LIBOR/ SWAP rates plus 200 basis points; (ii) deposits of 3-5 years maturity, interest shall be paid within the ceiling rate of LIBOR/ SWAP rates plus 400 basis points | Subject to cap as stipulated by the Department of Banking Operations and Development, Reserve Bank of India :<br>Banks are free to determine the interest rates of saving's and term deposits of maturity of one year and above.<br>Interest rates offered by banks on NRE deposits cannot be higher than | Banks are free to determine their interest rates on savings deposits under Ordinary Non-Resident (NRO) Accounts.<br>However, interest rates offered by banks on NRO deposits cannot be higher than those offered by them on comparable domestic rupee deposits. |

| S. No. | Particulars | Foreign Currency (Non-Resident) Account (Banks) Scheme [FCNR (B) Account] | Non-Resident (External) Rupee Account Scheme [NRE Account] | Non-Resident Ordinary Rupee Account Scheme [NRO Account] |
|---|---|---|---|---|
| | (1) | (2) | (3) | (4) |
| | | On floating rate deposits, interest shall be paid within the ceiling of SWAP rates for the respective currency/ maturity plus 200 bps/ 400 bps as the case may be. For floating rate deposits, the interest reset period shall be six months.<br>(valid up to November 30, 2013, subject to review) | those offered by them on comparable domestic rupee deposits.<br>With effect from August 14, 2013, banks may offer interest rates on deposits of 3 years and above without any ceiling. (valid up to November 30, 2013; subject to review) | |
| 7 | **Operations by Power of Attorney in favour of a resident by the non-resident account holder** | Operations in the account in terms of Power of Attorney restricted to withdrawals for permissible local payments or remittance to the account | Operations in the account in terms of Power of Attorney restricted to withdrawals for permissible local payments or remittance to the account | Operations in the account in terms of Power of Attorney is restricted to withdrawals for permissible local payments in rupees, remittance of |

| S. No. | Particulars | Foreign Currency (Non-Resident) Account (Banks) Scheme [FCNR (B) Account] | Non-Resident (External) Rupee Account Scheme [NRE Account] | Non-Resident Ordinary Rupee Account Scheme [NRO Account] |
|---|---|---|---|---|
| | *(1)* | *(2)* | *(3)* | *(4)* |
| | | holder himself through normal banking channels | holder himself through normal banking channels | current income to the account holder outside India or remittance to the account holder himself through normal banking channels.<br><br>Remittance is subject to the ceiling of USD 1 (one) million per financial year. |
| **8** | **Loans** | | | |
| | **a. In India** | | | |
| | **i) to the Account holder** | Permitted without any ceiling subject to usual margin requirements. | Permitted without any ceiling subject to usual margin requirements | Permitted subject to the extant rules[3] |
| | **ii) to Third Parties** | Permitted without any ceiling subject to usual margin requirements. | Permitted without any ceiling subject to usual margin requirements. | Permitted, subject to conditions[4] |

| S. No. | Particulars | Foreign Currency (Non-Resident) Account (Banks) Scheme [FCNR (B) Account] | Non-Resident (External) Rupee Account Scheme [NRE Account] | Non-Resident Ordinary Rupee Account Scheme [NRO Account] |
|---|---|---|---|---|
| | (1) | (2) | (3) | (4) |
| | **b. Abroad** | | | |
| | **i) to the Account holder** | Permitted | Permitted | Not Permitted |
| | **ii) to Third Parties** | Permitted | Permitted | Not Permitted |
| | **c. Foreign Currency Loans in India** | | | |
| | **i) to the Account holder** | Permitted without any ceiling subject to usual margin requirements. | Permitted without any ceiling subject to usual margin requirements. | Not Permitted |
| | **ii) to Third Parties** | Permitted without any ceiling subject to usual margin requirements | Permitted without any ceiling subject to usual margin requirements | Not Permitted |
| | **Purpose of Loan** | | | |
| | **a. In India** | | | |
| | **i) to the Account holder** | i) Personal purposes or for carrying on business activities* | i) Personal purposes or for carrying on business activities.* | Personal requirement and / or business purpose.* |

| *S. No.* | *Particulars* | *Foreign Currency (Non-Resident) Account (Banks) Scheme [FCNR (B) Account]* | *Non-Resident (External) Rupee Account Scheme [NRE Account]* | *Non-Resident Ordinary Rupee Account Scheme [NRO Account]* |
|---|---|---|---|---|
| | *(1)* | *(2)* | *(3)* | *(4)* |
| | | ii) Direct investment in India on non-repatriation basis by way of contribution to the capital of Indian firms/ companies<br><br>iii) Acquisition of flat/house in India for his own residential use (Please refer to para 9 of Schedule 2 to FEMA 5). | ii) Direct investment in India on non-repatriation basis by way of contribution to the capital of Indian firms/ companies.<br><br>iii) Acquisition of flat/house in India for his own residential use (Please refer to para 6(a) of Schedule 1 to FEMA 5). | |
| | **ii) to Third Parties** | Fund based and/or non-fund based facilities for personal purposes or for carrying on business activities*. (Please refer to para 9 of Schedule 2 to FEMA 5). | Fund based and/or non-fund based facilities for personal purposes or for carrying on business activities*. (Please refer to para 6(b) of Sch. 1 to FEMA 5) | Personal requirement and/or business purpose* |

| S. No. | Particulars | Foreign Currency (Non-Resident) Account (Banks) Scheme [FCNR (B) Account] | Non-Resident (External) Rupee Account Scheme [NRE Account] | Non-Resident Ordinary Rupee Account Scheme [NRO Account] |
|---|---|---|---|---|
| | *(1)* | *(2)* | *(3)* | *(4)* |
| | **b. Abroad** | | | |
| | **To the account holder and Third Parties** | Fund based and / or non-fund based facilities for bonafide purposes | Fund based and / or non-fund based facilities for bonafide purposes | Not permitted. |
| | * The loans cannot be utilised for the purpose of on-lending or for carrying on agriculture or plantation activities or for investment in real estate business. | | | |

**Notes:**

a. When a person resident in India leaves India for Nepal and Bhutan for taking up employment or for carrying on business or vocation or for any other purpose indicating his intention to stay in Nepal and Bhutan for an uncertain period, his existing account will continue as a resident account. Such account should not be designated as Non-resident (Ordinary) Rupee Account.

b. Authorised Dealers (ADs) may open and maintain NRE/FCNR (B) Accounts of persons resident in Nepal and Bhutan who are citizens of India or of Indian origin, provided the funds for opening these accounts are remitted in free foreign exchange. Interest earned in NRE/FCNR (B) accounts can be remitted only in Indian rupees to NRIs and PIO resident in Nepal and Bhutan.

c. In terms of Regulation 4(4) of the Notification No. FEMA.5/2000-RB dated May 3, 2000, ADs may open and maintain Rupee accounts for a person resident in Nepal and Bhutan.

d. The regulations relating to the various deposit schemes available to Non-Resident Indians have been notified *vide* Notification No. FEMA.5 dated 3rd May 2000, as amended from time to time. The relevant Notifications and A.P. (DIR

Series) Circulars are available on the website [www.rbi.org.in → Sitemap → FEMA → Notifications/A.P.(DIR Series) Circulars]. The Master Circular on Non-Resident Ordinary Rupee (NRO) Account [www.rbi.org.in → Sitemap → Master Circulars] may also be referred to. The details of rate of interest on the various accounts, are available in the **"Master Circular on Interest Rates on Rupee Deposits held in Domestic, Ordinary Non-Resident (NRO) and Non-Resident (External) (NRE) Accounts" and "Master Circular of instructions relating to deposits held in FCNR (B) Accounts"** issued by our Department of Banking Operations and Development, available on our website [www.rbi.org.in→ Sitemap → Master Circulars].

e. AD Category-I banks and authorised banks may credit the proceeds of account payee cheques/demand drafts/bankers' cheques, issued against encashment of foreign currency to the NRE account of the NRI account holder where the instruments issued to the NRE account holder are supported by encashment certificate issued by AD Category-I/Category-II.

f. AD Category-I banks and authorised banks may permit remittance of the maturity proceeds of FCNR (B) deposits to third parties outside India, provided the transaction is specifically authorised by the account holder and the Authorised Dealer is satisfied about the *bona fides* of the transaction.

## • INSURANCE POLICIES

Insurance, as the name suggests is an insurance against future loss. Life insurance is the most common insurance cover for an individual. Life Insurance is a contract providing for payment of a sum of money to the person assured, or following him to the person entitled to receive the same, on the happening of a certain event. It is a good method to protect your family financially, in case of death, by providing funds for the loss of income.

### Term Life Insurance

- o Lump sum is paid to the designated beneficiary in case of the death of the insured
- o Policies are usually for 5, 10, 15, 20 or 30 years
- o Low premium compared to other policies
- o Does not carry any cash value

**Endowment Policies**

- o Provide for periodic payment of premiums and a lump sum amount either in the event of death of the insured or on the date of expiry of the policy, whichever occurs earlier.

**Annuity/Pension Policies/Funds**

- o No life insurance cover but a guaranteed income either for life or a certain period.
- o Taken so as to get income after the retirement.
- o Premium can be paid as a single lump sum or through installments paid over a certain number of years.
- o The insured receives back a specific sum periodically from a specified date onwards (can be monthly, half yearly or annual).
- o In case of the death, it also offers residual benefit to the nominee.

**Units Linked Insurance Policy (ULIP)**

- o ULIP is a life insurance policy, providing a combination of risk cover and investment.
- o The dynamics of the capital market have a direct bearing on performance of ULIPs.
- o Most insurers offer a wide range of funds to suit one's investment objectives, risk profile and time horizons. Different funds have different risk profiles. The potential for returns also varies from fund to fund.
- o ULIPs offered by different insurers have varying charge structures. Broadly the different fees and charges include-Premium allocation charges, Mortality charges, fund management fees, policy/administration charges and fund switching charges.

**Postal Life Insurance**

PLI is the only insurer in the Indian Life Insurance market today, which gives the highest return (bonus) with the lowest premium charged for any product in the market.

A PLI/RPLI policy holder also gets following facilities :

- Change of nomination.

- The insurant can take loan by pledging his/her policy to Heads of the Circle/Region on behalf of President of India, provided the policy has completed 3 years in case of Endowment Assurance and 4 years in case of Whole Life Assurance. The facility of assignment is also available.
- Assignment of Policy to any Financial Institution for taking loan.
- Revival of his/her lapsed policy. Policy lapses after 6 unpaid premiums if it remained in force for less than 3 years and after 12 unpaid premiums if it remained in force for more than 3 years.
- Issue of Duplicate Policy Bond in case of the original Policy Bond is lost, burnt/torn/mutilation.
- Conversion from Whole Life Assurance to Endowment Assurance and from Endowment Assurance to other Endowment Assurance as per rules.

**Rural Postal Life Insurance (RPIL)**

RPLI offers following types of plans:

1. Whole Life Assurance (GRAMA SURAKSHA)
2. Convertible Whole Life Assurance (GRAMA SUVIDHA)
3. Endowment Assurance (GRAMA SANTOSH)
4. Anticipated Endowment Assurance (GRAMA SUMANGAL)
5. GRAM PRIYA
6. Scheme for Physically handicapped persons

The salient features of the Whole Life, Endowment, Convertible Whole Life and Anticipated Endowment Schemes of RPLI are the same as of the corresponding schemes of PLI except that the minimum Sum Assured is ₹ 10,000 and the maximum Sum Assured is ₹ 3 lakh. The maximum age limit of entry is 55 years in case of Whole Life and Endowment Assurance but 45 years in case of other plans.

All the schemes have compulsory medical examination. For the non-medical policies, the maximum limit of Sum Assured is ₹ 25,000/-, and maximum age is 35 years. In case of Non-standard age proof for Rural PLI policies, the maximum age limit is 45 years.

**DOs**

- ✓ Do review your insurance coverage
- ✓ Do consider how much life cover you need and your affordability to pay premium
- ✓ Do study details of various schemes
- ✓ Select a policy that suits you in terms of your requirement and premium outflows
- ✓ Do get an advice from an insurance professional who offers policies of different insurance companies
- ✓ Do go online to get the best quotes and verify the same before choosing one
- ✓ Do consider two single plans rather than joint cover
- ✓ Do disclose correct information in your application
- ✓ Do check and update your policy regularly

**DON'Ts**

- Don't purchase a policy unless you understand the concept behind it
- Don't buy life insurance unless you need it
- Don't opt for the cheapest deal without understanding the risk
- Don't forget to check for terminal illness benefits
- Don't limit your choice to one insurer
- Don't over-burden yourself with unaffordable premium outflows
- Don't blindly trust the information that is available online
- Don't lie in your medical exam
- Don't cancel any current insurance policy until you receive a certificate
- Don't do anything to hinder an investigation if you file a claim
- Don't default on your payments which may lead to cancellation at the time of need
- Don't forget to report accidents and mishaps to your insurance company, even if you don't plan on filing a claim

- **GOVERNMENT SCHEMES**

The Government offers a wide variety of savings/investment products:

**i. National Savings Certificates (NSC)**

- o Popular Income Tax Savings scheme, available throughout the year
- o Interest rate of 8.5% & 8.8% respectively for 5 year and 10 year NSCs
- o Minimum investment ₹ 100, no upper limit
- o Maturity period of 6 years
- o Transferable and a provision of loan

**ii. Public Provident Fund (PPF)**

- o Tax free interest rate of 8.7% p.a w.e.f 1st April 2013
- o Minimum investment limit is ₹ 500 and maximum is ₹ 1,00,000/-
- o Maturity period of 15 years
- o The first loan can be taken in the third financial year from the date of opening of the account, or up to 25% of the amount at credit at the end of the first financial year. Loan amount can be returned in maximum of 36 installments
- o A person can withdraw an amount (not more than 50% of the balance) every year from the 7th year onwards

**iii. Post Office Scheme (POS)**

- o One of the best Tax Saving Schemes
- o It is available throughout the year
- o Post Office schemes depends upon the type of investment and maturity period, which can be divided into following categories: Monthly Deposit/Saving Deposit/Time Deposit/ Recurring Deposit

**iv. Infrastructure Bonds**

- o Lock in period of three years
- o Tax benefit u/s. 88 on investments up to ₹ 20,000

- o Any redemption prior to maturity nullifies the tax exemption

**v. Kisan Vikas Patra (KVP)**

- o Money invested in this scheme doubles in 8 years and 7 months
- o There is a minimum investment limitation of ₹ 100 with no upper limit
- o This scheme is available throughout the year
- o Currently, there is no tax benefit on investment under this scheme

**Table on Current Interest Rates on the following Investments**

| **Scheme** | **Interest Rates** | **Interest Rates** | **Maturity** | **Remarks** |
|---|---|---|---|---|
| | **w.e.f. April 1, 2013** | **Prior to April 1, 2013** | | **w.e.f. April 1, 2013** |
| PPF | 8.70% | 8.80% | 15 Years | Investment limit maintained at ₹ 1 lakh; Tax Deduction u/s 80C |
| MIS | 8.40% | 8.50% | 5 Years | N.A. |
| NSC (VIII Issue) | 8.50% | 8.60% | 5 Years | Maturity Value – 151.62% or 1.5162 Times of Investment |
| NSC (IX Issue) | 8.80% | 8.90% | 10 Years | Maturity Value - 236.60% or 2.366 Times of Investment |
| SCSS | 9.20% | 9.30% | 5 Years | Interest Payable Quarterly; Tax Deduction u/s. 80C |
| Recurring Deposit | 8.30% | 8.40% | 5 Years | Maturity Value - Approximately 7456.6% or 74.566 Times of Monthly Investment |

| Scheme | Interest Rates | Interest Rates | Maturity | Remarks |
|---|---|---|---|---|
| Term Deposits | 8.40% | 8.50% | 5 Years | No. change in I-Year Term Deposti Rate; Investment in 5-Year Term Deposit qualifies for Tax Deduction u/s. 80C |
| | 8.30% | 8.40% | 3 Years | |
| | 8.20% | 8.30% | 2 Years | |
| | 8.20% | 8.20% | 1 Years | |
| Savings A/c. Deposit | 4% | 4% | N.A. | N.A. |

- **Where NOT to invest?**

o **Money Circulation Schemes (MCS) Multi-Level Marketing Schemes (MLM) Network Marketing (NWM) Self Employment Yojana (SEY)**

By enrollment into such scheme, one gets back some or full initial investment and then keeps gaining financially by enrolling new members. So also the second set of enrollers keeps multiplying and gain financially, luring every onlooker. Such a system of chain to work endlessly to provide profit to everyone concerned ultimately breaks down at some stage, resulting in big financial losses to many.

When a person fails to get his required clients or enrollers, the promoters of the scheme do not tell about the non-viability of the scheme but blame it as one's personal failure. Many companies have now disguised into the activity of marketing goods, services, drugs and health care products.

o **Chit Funds**

Chit fund is a kind of savings scheme under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money by way of periodical installments over a definite period and that each such subscriber shall, in his turn, as determined by lot or by auction or by tender, be entitled to the prize amount. However, there are many such schemes which have been misused by their promoters and there are many instances of the founders running what is basically a Ponzi scheme and absconding with their money.

- **Deposits**

  Finance Companies take deposits from the public, promising them unusually high returns.

  Since high returns are unsustainable, ongoing repayments of interest and deposit amounts depend on continuous and uninterrupted flow of fresh deposits. At some stage, when the flow of deposits gets stifled, the payments to the investors stop, leaving them high-and-dry.

- **Private Placements**

  Many companies offer equity shares/convertible debentures/ preference shares etc., to the public through the private placement route, often for "a mega project' and promise dream returns. By law, such securities cannot be sold to more than 49 persons, beyond which the Company is required to come out with a Public Issue under the guidelines of SEBI.

- **Plantation Companies**

  Many companies offer schemes that multiply money by investment into plantations. Most of such companies are not registered with SEBI, and typically have fled with the investors' monies.

**Caution – "suspect for safety"**

There can be no free lunch and that there is some catch when someone offers to make money for you easily and quickly. Getting rich quick scheme or high returns schemes should be suspected. Such schemes are unsecured, are illegal and are not regulated by the Government. Therefore, if you lose money, you will not be able to seek any help from the Government.

# X. DOCUMENTING YOUR INVESTMENTS

**Financial Plan and its importance**

A financial plan is a series of steps which are carried out, or goals that are accomplished, which relate to an individual's financial affairs. It is a series of steps or specific goals undertaken for spending and saving future income. This plan allocates future income to various types of expenses and also reserves some income for short-term and long-term savings.

The importance of financial planning especially in the present scenario cannot be overstated. Among others, two factors are responsible for the same i.e. inflation and changing lifestyles. Inflation is a situation where too much money chases a limited number of goods. This leads to a fall in the value of money. It is also expressed as a rise in the general price level. Financial planning can ensure that one is equipped to deal with the impact of inflation, especially in phases like retirement when expenses continue but income streams dry up. The second factor is changing lifestyles. With higher disposable incomes, it is common for individuals to upgrade their standard of living. Apart from these, there are contingencies like medical emergencies or unplanned expenditure that an individual might have to cope with. Sound financial planning can enable him to easily mitigate such situations, without straining his finances.

It is possible to manage income effectively through financial planning. It helps in segregating it into tax payments, other monthly expenditures and savings. Financial planning is also necessary from the point of family security. The various policies available in the market serve the purpose of financially securing the family. The savings created through appropriate planning come to the rescue in difficult times. Death of the bread winner in a family, affects the standard of living of the family to a great extent. A proper financial plan such as a Will, Settlement Deed and various other investment instruments act as a guard in such situations and enable the family to survive hard times.

**How to document your investments?**

Next comes the important part of documenting these investments. It is not just necessary to do appropriate financial planning but the investor should be wise enough to document all these investments. There may be several ways of investments but the investor should be able to remember and keep track of these investments. For this he needs to ensure that he documents all his investments and keeps it in a place that is easily accessible.

**Do's and Don'ts**

✓ The investor should be always aware of his legal rights under each investment. For this, he should always read the investment documents and understand his legal rights.

✓ Copies of all investment documentation i.e. Xerox copies of application forms, acknowledgement slips, agreements, contract notes, insurance policies etc. should be kept safely in a place that is accessible to the investor.

✓ The dates of opening and closing of accounts, dates of maturity (for e.g. fixed deposits etc.), periods of interest, whether monthly or annual, pension due dates etc. may all be jotted down on a sheet of paper. They can also be drafted in an excel sheet format and saved in the computer.

✓ Details of each instrument may be detailed in the excel sheet. History of the instrument and how it was acquired can also be mentioned.

✓ Face Value of each instrument and returns expected from that instrument may also be mentioned in the excel sheet.

✓ In case of Power of Attorney, the parties and the powers given may be mentioned.

✓ In case of Will, the details of properties bequeathed and the beneficiaries may be mentioned in the excel sheet.

✓ Where it is a Private Trust, the purpose of the trust, the parties etc. may be mentioned.

✓ In case of Partition, the details of immovable property partitioned, the parties involved may be noted in the sheet.

✓ Where it is a Settlement Deed, the parties and property involved can be mentioned.

✓ All though the basic preparation of this document of investments may take some time and patience, this will surely go a long way in saving our time and energy in future. This will be a great reckoner not only for the investor but also for any other person handling on behalf of the investor in terms of distress.

✓ Apart from the above, the document will also be of great help in tax planning and submitting the tax returns.

**Format of documenting the investments**

| Sl. no. | Type of instrument | Name of bank/ company etc. | Date of opening/ purchase | Date of maturity | Face value of the instrument (₹) | Expected return | Comments |
|---|---|---|---|---|---|---|---|
| | Fixed deposit | | | | | | |
| | Recurring deposit | | | | | | |
| | Insurance policy | | | | | | |
| | Shares | | | | | | |
| | | | | | | | |

| Sl. no. | Type of instrument | Date of document | Parties to the document (deed) | Details of movable property | Details of immovable property | Comments |
|---|---|---|---|---|---|---|
| | Will | | | | | |
| | Settlement deed | | | | | |
| | Gift | | | | | |

**Important Deeds and Documents**

***a. Gift***

According to Sec. 122 of The Transfer of Property Act, 1882, "Gift is the transfer of certain existing movable or immovable property made voluntarily and without consideration, by one person, called the donor, to another, called the donee, and accepted by or on behalf of the done."

A gift is a common mode of transfer of property. It is the transfer of certain existing movable or immovable property by one person to another. The transfer should be made voluntarily and without consideration. The person transferring the property is called the donor. The person to whom the property is transferred is referred to as the donee. The donee must accept the property during the lifetime of the donor and while he is still capable of giving. In case the donee dies before acceptance, the gift is void.

The essential elements of a gift are –

1) Voluntary
2) Without consideration
3) Donor
4) Donee
5) Competence to gift
6) Subject matter of gift
7) Transfer
8) Acceptance

**DEED OF GIFT OF IMMOVABLE PROPERTY**

THIS DEED OF GIFT is made at ……….......... this ........ day of ……….…... between Mr. ………… of ……………...... hereinafter referred to as 'the DONOR' of the One Part and Mr. …………. of ....... hereinafter referred to as 'the DONEE', of the Other Part.

WHEREAS the DONOR is seized and possessed of the land and premises situated at ......... and more particularly described in the Schedule hereunder written.

AND WHEREAS the DONEE is related to the Donor as ........

AND WHEREAS the DONOR desires to grant the said land and premises to the DONEE as gift in consideration of natural love and affection as hereinafter mentioned.

AND WHEREAS the DONEE has agreed to accept the gift as is evidenced by his executing these presents.

AND WHEREAS the market value of the said property is estimated to be ₹ ……….......

NOW THIS DEED WITNESSETH that the DONOR without any monetary consideration and in consideration of natural love and affection, which the DONOR bears to the DONEE, doth hereby grant and transfer by way of gift, the said land and premises situated at ………………...... and more particularly described in the Schedule hereunder written together with all the buildings, and structures thereon and all the things permanently attached thereto or standing thereon and all the liberties, privileges casements and advantages appurtenant thereto and all the estate, right, title, interest use, inheritance, possession, benefit, claims and demand whatsoever of the DONOR To Have And To Hold the same unto and to the use of the DONEE absolutely but subject to the payment of all taxes, rates, assessments, dues and duties now and hereafter chargeable thereon to the Government or Municipality or other Local Authority.

AND he the DONOR doth hereby covenants with the DONEE;

(a) That the DONOR now has in himself, good right, full power and absolute authority to grant the said piece of land and other premises hereby granted as gift in the manner aforesaid.

(b) The DONEE may at all times hereafter peaceably and quietly enter upon and occupy, possess and enjoy the said piece of land and premises and receive the rents, issues and profits and rents thereof and every part thereof to and for his own use and benefit without any suit, lawful eviction, interruption, claim or demand whatsoever from or by the DONOR or his heirs, executors, administrators and assigns or any person or persons lawfully claiming or to claim by, from, under or in trust for the DONOR.

(c) That the said land and premises are free and clear and freely and clearly and absolutely and forever released and discharged or otherwise by the DONOR and well and sufficiently saved, kept harmless and indemnified of and from and against all former and other estate, titles, charges and encumbrances whatsoever, had made, executed, occasioned or suffered by the DONOR or by any other person or persons lawfully claiming or to claim by from, under or in trust for the DONOR.

(d) AND FURTHER that the DONOR and all persons having or lawfully claiming any estate or interest whatsoever to the said land and premises or any part thereof from under or in trust for the DONOR or his heirs, executors administrators and assigns or any of them shall and will from time to time and at all times hereafter at the request and cost of the DONEE do and execute or cause to be done and executed all such further and other acts, deeds, things, conveyances and assurances in law whatsoever for better and more perfectly assuring the said land and premises and every part thereof unto and to the use of the DONEE in the manner aforesaid as by the DONEE, his heirs, executors, administrators and assigns or counsel in law shall be reasonably required.

IN WITNESS WHEREOF the DONOR as well as the DONEE (by way of acceptance of the said gift) have put their respective hands the day and year first hereinabove written.

***THE SCHEDULE ABOVE REFERRED TO***

Signed and Delivered by the within named DONOR........

Signed by within named DONEE........

Witnesses

1..............

2..............

**DEED OF GIFT OF MOVABLE PROPERTY**

I, Mr/Mrs. ............. residing at .......................... do hereby make a gift of the ornaments and jewellery specified in the schedule hereunder to my daughter Miss ............ in consideration of natural love and affection on the occasion of her marriage.

SCHEDULE

Signed by the DONOR

Accepted by the DONEE

Witnesses

1............

2............

### b. Partition

Partition is a division of joint right into several rights. It is different from gift or transfer of property. Partition refers to the severance of joint status. There should be a definite and unanimous indication of intention by the members of the joint family to separate.

The joint family properties are divided by metes and bounds among members. In case certain properties cannot be divided because it is impracticable or unreasonable, then partition can be effected by giving monetary compensation or allocating some other assets.

Joint family property can be partitioned through a partition deed.

### DEED OF PARTITION BETWEEN CO-OWNERS

Shri…….s/o……… residing at …………………….. (hereinafter called the FIRST PARTY), and Shri ………..s/o……………… residing at ……………….. (hereinafter called the SECOND PARTY) and Shri…….s/o……… residing at ………………… (hereinafter called the THIRD PARTY) do hereby execute this DEED OF PARTITION between themselves on this ………………. day of ……………..

WHEREAS the aforesaid parties are the co-owners in equal shares of the properties mentioned in the Schedules 1, 2, and 3 of this deed of partition.

WHEREAS the aforesaid properties were purchased by the aforesaid parties on …………. from Shri…………………… s/o ………………. residing at ………………………. vide sale-deed dated …….. and registered on ……….. at ……………..

AND WHEREAS the aforesaid parties have mutually agreed to divide the said properties amongst themselves in order to avoid any future dispute with regards to the said properties.

AND WHEREAS the aforesaid parties have agreed to assign the land comprising an area of …………………..bearing No……….……. situated at………, mentioned and mapped in Schedule 1 to the FIRST PARTY and the land comprising an area of …….. situated at…………….. bearing No……… detailed in Scheduled 2 to the SECOND PARTY and the land along with the trees standing thereon comprising an area of ……………. situated at …………… bearing No ……… detailed in Schedule 3 to the THIRD PARTY. The aforesaid parties have also mutually agreed that the aforesaid parties will become sole and absolute owners of the allotted properties.

AND WHEREAS the aforesaid parties have taken possession of the properties assigned to them as aforesaid.

NOW THIS DEED WITNESSETH AS FOLLOWS:

1. That in consideration of the right title and interest made in accordance with the aforesaid terms of this deed and in accordance with the conditions hereinafter mentioned release and relinquish their interest in the properties allotted to other parties and each of the said parties hereby conveys to each other's party separately his right, title and interest therein so as to constitute each party to this deed the sole and absolute owner of demands of other thereto or concerning therewith, as from the date of this deed.

2. That the original deed of partition shall be retained by first party, and true copy thereof signed by each party has been delivered to the other said parties who shall be entitled to require production of the original from the first party before any Court or public office or Bank or Insurance Company etc. if so desired.

3. That the parties have agreed that all taxes and public charges in respect of the allotted properties shall be borne by the parties themselves.

4. That each party will execute such deed or do all other acts necessary which may be requisite for more effectually assuring the party so requiring and at his cost, in the manner required by law and appear before revenue or other authorities to have mutation effected in respect of the party assigned to the party concerned.

5. That the valuation of the entire property under this partition-deed is fixed at ₹ __________.

Schedule-1

Schedule-2

Schedule-3

IN WITNESS WHEREOF the aforesaid parties have signed this deed of partition on the day and year first before written.

Sd/-

1. FIRST PARTY

2. SECOND PARTY

3. THIRD PARTY

Witnesses :

1………………………..

2………………………..

**c. Power of Attorney**

A power of attorney is an instrument whereby a specified person or persons are empowered to act for and in the name of the person executing the instrument ("donor").

Power of Attorneys are specifically or incidentally referred to in several statutes. It is a type of agency, and law relating to the powers of attorney which forms part of the general law of agency. The law of agency in India is contained in Chapter X, sections 182 to 238 of the Indian Contract Act, 1872. The statutory provisions concerning Power of Attorneys are found in the Powers of Attorney Act, 1882.

A power of attorney need not be attested or registered. However if at the time of execution of a Power of Attorney, the principal resides in any part of India, and the Power of Attorney authorizes a person to present documents at the registration office for registration, it has to be executed and authenticated by the Registrar or Sub-Registrar within whose district or sub-district the principal resides.

In case the principal does not reside in India, it must be executed and authenticated by a Notary Public, or any Court, Judge, Magistrate, Indian Consul or Vice Consul, or representative of the Central Government in the country in which the principal is residing at the time of executing a power of attorney.

**GENERAL POWER OF ATTORNEY**

KNOW ALL MEN BY THESE PRESENTS THAT

I, ...................... son of ............................., resident of .................. at present residing at ............... state as follows:

WHEREAS I own various movable and immovable properties in various parts of India described in the Schedule I hereto and I have interest in various firms, companies, association of persons, trusts, societies as partner, proprietor, shareholder, member, trustee, beneficiary, etc. and/or otherwise, described in the Schedule II hereto.

AND WHEREAS I am presently residing out of India as mentioned hereinabove for the time being, I am personally unable to attend to my day-to-day affairs and for reasons of convenience it is necessary that I should appoint an attorney and confer upon him the powers hereinafter stated.

NOW KNOW BY THESE PRESENTS that I the said ................ do hereby nominate and constitute and appoint Shri ......................... son of late ...................... at present residing at ..................... as my true and lawful Attorney for me in the name and on behalf of myself and/or my said Attorney and in any of my said capacities and in the name and on behalf of any partnership firm, association of persons, trustee, beneficiary or businesses in which I am now or may in future in any manner become interested to do exercise, execute and perform all or any of the following acts, deeds and things, namely:-

**1. Commercial**

1.1 To transact business:- To commence, transact, manage, carry on, close down any of my business and to do all things requisite or necessary or connected therewith including correspondence with any person or authority.

1.2 To buy and sell:- To buy, receive, store and hold and to sell, pledge, hypothecate, give on hire or otherwise deal with any goods, articles, things or movable property.

1.3 To open branches:- To open, establish, conduct, shift and/or close any branch of any business at any place or places.

1.4 To contract:- To enter into, sign, execute, vary, alter, terminate, suspend, and repudiate any contracts.

1.5 Partnership business:- To act as a partner in the firm or firms in which I am a partner at present or become a partner in future and commence, carry on, close, dissolve or retire from any business of any partnership with any person and for the said purpose to do all acts as partner or partners therein including banking operations, execution of partnership, retirement, dissolution or other deeds and documents.

**2. Property**

2.1. To acquire and to transfer:– To purchase, take on lease, to take charge or mortgage on and to acquire in any manner and to sell, mortgage, settle, charge, lease, grant tenancy or otherwise transfer and/or in any manner and/or on any terms deal with any immovable or real property or properties or any interest therein.

2.2. To manage and maintain:– To hold, defend possession, manage and maintain movable, or immovable properties described in Schedule 1 herein and other immovable properties acquired by me hereafter.

2.3. To receive rents, etc.:– To demand, recover and receive rents, *mesne* profits, licence fees, maintenance charges, electricity charges, corporation taxes and all other sums of moneys receivable in respect of my properties and to make all just and reasonable allowance therein in respect of rates, taxes, repairs and other outgoings and to take all necessary steps whether by action, distress or otherwise to recover any property or sums of money in arrear.

2.4. To pay outgoings:– To pay all taxes, rates, assessments, charges, expenses and other outgoings whatsoever payable for or on account of my properties or any part thereof and to insure any buildings thereon against loss or damage by fire and other risks as be deemed necessary and/or desirable and to pay all premia for such insurances.

2.5. To serve notice on tenants:– To sign and give any notice to any occupier of any property belonging to me to quit or to repair or to abate any nuisance or to remedy any breach of covenant or for any other purpose whatsoever.

2.6. To construct, repair and/or reconstruct:– To take down, demolish, rebuild and/or repair any of my house, building or other structure of whatever nature.

2.7. To get utilities:– To apply for and obtain electricity, gas, water, sewerage and/or connections of any utilities and/or to make alterations and/or close down and/or have disconnected the same in my properties.

2.8. To view the condition of any property:– To enter upon any of my property or any part of it as often as be desired to view the state of repair thereof and to require any occupier as a result of such view to remedy any want of repair or abate any nuisance.

2.9. To enforce covenants:– To enforce any covenant in any lease, licence or tenancy agreement or any other document affecting any of my property and if any right to re-enter arises in any manner under such covenants or under notice to quit, then to exercise such rights amongst others.

2.10. To deal with trespassers:– To warn off and prohibit and if necessary proceed against in due form of law against all trespassers on any of my property and to take appropriate steps whether by action or otherwise and to abate all nuisances.

2.11. To prepare and have sanctioned the plans:– To get prepared plans for construction of any building or structure and/or otherwise on any of my property and to have the same sanctioned, modified and/or altered by any Corporation, Municipality or other authority and in connection therewith or to make necessary applications, give undertakings, pay fees, obtain sanctions and such other orders and permissions as may be expedient.

2.12. To apply for obtaining building materials:– To apply for and obtain such permission as may be necessary for obtaining steel, cement, bricks and other construction materials and construction equipments and to appoint architects and contractors for the construction of building or buildings to be constructed on the plots belonging to me.

2.13. To act in proceedings under rent control legislation:– To appear and represent in any proceedings for fixation of fair rent and/or for any other purpose or purposes before any court, Rent Controller or other authority in connection with any matter relating to and/or arising out of any of my property.

2.14. To obtain any certificate:– To apply for and obtain such certificate and other permissions and clearances including certificates and/or permission under any law relating to ceiling on urban land, or other law relating to land and/or buildings both urban and rural or under the Income-tax Act or any other law as may be required for execution and/or registration of any conveyance or other document and/or for transferring any rights in any land, building or other property belonging to me or acquired by me hereafter.

2.15. To file declarations:– To prepare, sign, declare and file declarations, statements, applications and/or returns and otherwise in connection with holding, possessing, acquiring, transferring, partitioning or otherwise dealing with any of my property before any appropriate or other authority as may be required under any law or laws now prevailing or as may in future become applicable and to do, exercise, execute and perform any or all the necessary acts, deeds and things required thereunder.

**3. Banking**

3.1. Banking operation:– To open, operate, continue or close any account including any overdraft or other loan account and/or saving account, current, fixed or other accounts and also safe deposit lockers and all accounts whatsoever in my name and on my behalf with any bank or banks that may be existing or may in future be opened in my name or in the name of my firm or firms or business or businesses or in my capacity as trustee or beneficiary of any trust with any bank or banks including Postal Savings Bank.

3.2. Drawing and negotiations of cheques:– To draw, sign, negotiate and/or endorse cheques, payment orders, drafts, dividend warrants and/or any other instruments and to execute, enter into, acknowledge, do and present all such deeds, instruments, contracts, agreements, acts, deeds and things as shall be requisite or deemed fit and proper for or in relation to all or any of the purposes, matters or things herein contained or others with any bank or banks.

3.3. To deal with bills of exchange:– For all or any of the banking purposes to draw, accept, endorse, discount or otherwise deal with any bills of exchange, bills of lading, delivery orders, promissory notes or other mercantile instruments relating to money, goods, properties or otherwise.

3.4. To operate bank locker or safe deposit vault locker:– To operate any bank locker or safe deposit vault locker and to deposit therein and withdraw therefrom any articles belonging to me.

**4. Miscellaneous**

4.1. To agree to charge or pay any interest or other considerations for any loan and/or advance and to vary such rates of interests or consideration from time to time.

4.2. To remit, reduce or settle any claim of any moneys, losses and/or damages.

**5. Representations**

5.1. To represent before bank or banks, insurance companies, etc:– To represent me or any of my firm or firms or business in any of the bank or banks, insurance companies, courts, registration offices, municipal offices, office of competent authority, urban land ceiling, post offices, sales tax offices, income-tax offices, customs offices, revenue offices or any co-operative society, Central or any other State Government or other authority, society, body corporate or other person for any purpose or purposes whatsoever and do all acts as may be expedient before the same or in connection therewith.

5.2. To prepare, sign and file tax returns:– To prepare, sign, execute and/or file any of my and/or any of my firm or firms or business or businesses in my personal capacity or as trustee or beneficiary of any trust, sales tax returns, income-tax returns, or any other returns under the Income-tax Act, 1961, Wealth-tax Act, 1957, Gift-tax Act, 1958 and/or any other law for the time being in force or other returns, statements, papers, documents in connection with the aforesaid Acts, to sign and/or submit returns, statements of accounts, balance sheets, declaration forms, to receive refund orders or vouchers from any of the aforesaid authorities, to apply for and to sign and submit to necessary authorities and to represent me or any of the firm or firms or business or businesses, trusts, proprietary concerns in which 1 am now or may hereafter be interested as proprietor, partner, trustee or beneficiary with such authority or authorities concerned therewith.

5.3. Appear before Assessing Officer, etc.:– To appear before any Assessing Officer, Deputy Commissioner and/or Assistant Commissioner and/or Commissioner and/or Central Board of Direct Taxes and/or tribunal and/or any other authority or authorities in connection with any matter or matters and to represent me or my proprietary concerns, firm or firms, business or businesses, trusts in which I am trustee or beneficiary and to produce, explain accounts, documents and papers as may be necessary and to pay taxes and other amounts to such authorities and to any other authority by virtue of these presents and to sign, execute and deliver all other papers, documents and deeds in connection therewith.

5.4. To appear before registrar, notary public, magistrate, etc.:– To appear before any Notary Public, Registrar of Assurances, District Registrar, Sub-Registrar of Assurances, Metropolitan Magistrate and other officer or officers or authority having jurisdiction and to acknowledge and register or have registered and perfected all deeds, instruments and writings, executed, signed or made by me personally or as partner of any firm or firms or business or businesses or by my said attorneys or any of them by virtue of the powers herein conferred.

**6. Execution and registration of documents**

6.1. To execute documents (stocks, shares, annuities):– To execute all deeds and other instruments necessary or proper for transferring any stock, shares, annuities, debentures, obligations and other securities held by me or to be acquired by me hereafter to the purchaser or purchasers thereof.

6.2. To execute and register deeds:– To sign, execute, enter into, modify, cancel, alter, draw, approve, present for registration and admit registration of all papers, documents, contracts, agreements, conveyances, mortgage deeds, leases, grants, assurances, applications, declarations, trust deeds and other documents as may in any way be required to be so done for or in connection with any movable or immovable property belonging to me or to be acquired by me hereafter or of any part thereof or any interest therein including those held by me as owner, lessor, lessee, partner, mortgagor, tenant, trustee or otherwise be interested for the time being including those connected with the management and development of any business and also in connection with the sale, purchase, lease, transfer and disposition or construction or sanction of plan or obtaining of clearances or permits from the Government or for any other purpose whatsoever.

**7. Legal proceedings**

7.1. To compound the debts and to submit claims to arbitration:- To compound with or make allowances to any person for or in respect of any debt or demand whatsoever which now is or shall or may at any time hereafter become due or payable to me and to take or receive any composition or dividend thereof or thereupon and give receipts, releases or other discharges for the whole of the same debts, sums or demands or to settle, compromise or submit to arbitration every such debt or demand and every other claim, right, matter and thing due to or concerning me and for that purpose in my name to enter into, make, sign, execute such agreements as are necessary in like cases, execute such agreements for arbitration or other deeds or instruments as are necessary in like cases and to allow time for the payment of any such debt or demand (with or without security) upon such terms as the attorney may think fit.

7.2. To conduct and defend legal proceedings:– To commence, prosecute, enforce, defend, answer or oppose all notices, suits, and other legal proceedings and demands touching any of the matters aforesaid or any other matters in which I am now or may hereafter be interested or concerned and also if thought fit with such consent as aforesaid to compromise, refer to arbitration, abandon, submit to judgment or become non-suited in any such action or proceeding as aforesaid before any court, civil, or criminal, or revenue including the Rent Controller, City Civil and Small Causes Courts.

7.3. To appoint advocates, etc.:– To appoint any solicitor, advocate, pleader or counsel as may be necessary for prosecuting and defending any suit or proceedings, in the matters relating to my properties, business, firm, trusts, companies or organisations, in which I am interested or become interested hereafter in my name or in the name of my said attorney as he may think fit and proper and to sign vakalatnamas, warrant of attorney in favour of any solicitor, advocate, pleader or counsel engaged by him.

7.4. To sign plaints and other papers:– To sign, declare and/ or affirm any plaints, written statements, petitions, consent petition, affidavits, memorandum of appeal or any other document or paper in my name in any proceeding or in any way connected therewith.

7.5. To deposit and receive documents from court:– To deposit and receive documents and money from any court or courts and/ or any other person or authority in my name and give valid receipts and discharges thereof.

**8. Receipts and discharges**

8.1. Receive money and goods:– To demand, collect, sue for, recover and receive from all and every person or persons, body or bodies, political or corporate, court or authority including government and/or local bodies whomsoever concerned or chargeable therewith all or every sum or sums of money including rent, documents, securities, goods, effects, dues, duties, interests, rents, profits, income, purchase consideration, dividends, compensation and/or any other money which shall belong or be or become payable to me or to any of my firm or firms, business or businesses or companies in which I am interested.

8.2. To collect debts:– To demand, collect, sue for, recover and receive in my name, from all and every person, body, political or municipal or corporate or firm or company wheresoever and whatsoever all sums of money, debts, dues, goods, wares, merchandise, chattels, effects and things of any nature or description whatsoever which now are or which at any time or times hereafter shall or may become due or owing or payable to or recoverable including those from or by the bank by virtue of any hypothecations, bonds, mortgages, pledges, agreements or other securities whatsoever or upon or by virtue of any bills of exchange, promissory notes, cheques, bills of lading or other mercantile or negotiable instruments whatever or otherwise.

8.3. To give receipts:– To receive and give effectual receipts and discharges in my name for all monies, securities for monies, debts, goods, chattels and personal estate which are or may become due, owing, payable or transferable in or by any right, title, ways or means howsoever from any person or persons or corporation or other body or authority.

8.4. To receive debts, gifts, legacies, etc.:– To receive and give good and valid receipts and discharges in my name for share of assets of any business or for the purchase money of any share therein or of any part of such share and all such other monies as may be payable to me in any manner whatsoever.

**9. Agents**

9.1. Agency:– To act as agents for any person or to appoint any person as agent for any purpose in connection with any business or matter herein contained or otherwise and on such terms and with such powers and authorities as may be deemed by my said attorney to be expedient and to vary, modify and/or terminate such appointment and/or appointments and make other or others.

9.2. To employ persons in any capacity:– To employ any person in any capacity for my business firm, trusts, companies in which I am interested and require to employ such person or become interested in future and require to employ such person and to suspend, dismiss or discharge any employee so employed as my said attorney may deem fit.

9.3. To employ professionals:– For better and more effectually executing the powers or authorities aforesaid or any of them to retain and employ solicitors, advocates, chartered accountants, managers, consultants or any other professional persons and/or debt collecting or other agents.

And generally my said attorney shall have the power to do all such acts, deeds and things on my behalf as I could have lawfully done, if personally present.

AND I do hereby ratify and confirm and agree to ratify and confirm all and whatsoever my said attorney shall lawfully do or cause to be done by virtue of these presents.

IN WITNESS WHEREOF, I .............................. have hereunto set my hand this....................... day of .................... 20---.

Schedule I above referred to

Schedule II above referred to

Signed and delivered by the within named

.................

WITNESSES;

1.

2.

**SPECIAL POWER OF ATTORNEY**

If an instrument is executed for specified act or acts, it is called a "Special Power of Attorney". In other words, a Power of Attorney conferring on the agent the authority to act in single or specified transactions in the name of the principal is known as special power-of-attorney.

**POWER OF ATTORNEY TO EXECUTE SALE DEED**

BY THIS POWER OF ATTORNEY, I --------------, s/o -------------------- residing at ---------------- do hereby appoint ----------------, s/o ------------------, residing at ----------------------- to be my Attorney for me and in my name and on my behalf.

1. To negotiate and sell my property situated at ----------------- to any purchaser at such price and at such time as my said Attorney may in his absolute discretion think proper to agree upon and for such purpose to execute any document, deed or other papers and to present the same for registration and to admit the execution thereof.

2. To receive from the purchaser the consideration money for the said property and to give receipt and discharge therefore as may be required.

3. To deliver physical possession in the manner that is possible in the circumstances of the said property at ------------------ to the purchaser or to the nominee of the purchaser.

4. To apply to the Municipal Corporation of -------------- for mutation of the said property in favour of and in the name of the purchaser or his nominee and to do and execute all deeds, assurances and to do all such acts as may be necessary to fully effectuate the sale of the said property.

I hereby agree and undertake to ratify all acts, deeds, assurances, done, given, executed or made by my said Attorney under the powers conferred by this Power of Attorney as if the same were done or made by me personally.

IN WITNESS WHEREOF, I ............................. have hereunto set my hand this...................... day of ................... 20--.

(Signature)

WITNESSES:

1.

2.

### d. Trust Deed

The instrument by which the trust is declared is called instrument of Trust, and is generally known as Trust Deed.

It is well settled that no formal document is necessary to create a Trust as held in *Radha Soami Satsung vs. CIT- (1992) 193 ITR 321 (SC)*. But for many practical purposes a written instrument becomes necessary under following cases –

i) When the trust is created by a Will irrespective of whether the trust is public or private or it relates to movable or immovable property. This is because as per Indian Succession Act, 1925, a Will has to be in writing.

ii) When the trust is created in relation to an immovable property of the value of ₹ 100 and upwards, in case of a private trust. In case of public trusts, a written trust deed is not mandatory, even in respect of immovable property, but is optional.

iii) Where the trust/association is being formed as a society or company, the instrument of trust; i.e., the memorandum of association, and Rules and Regulations has to be in writing.

A person drafting the deed of a public charitable trust has to bear in mind several enactments, particularly the Indian Trusts Act, 1882, any local enactment relating to trusts, like the Bombay Public Trusts Act, 1950 for the State of Maharashtra and the Income-tax Act, 1961.

**DEED OF TRUST**

THIS DEED OF TRUST made at _______ this day of _______ 20— BETWEEN ________________ residing at ____________ __________ hereinafter called "The Settlor" (which expression shall unless it is repugnant to the context or meaning thereof be deemed to include his heirs, executors and/or administrators) of the One Part

AND

(1) -------------------- residing at ______________ AND (2) -------
----------- residing at _________________, hereinafter called "The Trustees" (which expression shall unless it be repugnant to the context or meaning thereof be deemed to include the survivors of survivor of them and the heirs, executors and administrators of the last survivor and the trustees or trustee for the time being of these presents, their, his or her assigns) of the Other Part;

(i) WHEREAS the Settlor is seized and absolutely possessed, inter alia, of an amount of ₹__________/- (Rupees_____________ only) in cash;

(ii) WHEREAS out of natural love and affection which the Settlor bears towards the beneficiaries (i) ____________________ and (ii) __________________ who are the ___________ (relationship) of the Settlor, the Settlor is desirous of settling a sum of ₹_____/- (Rupees ______________ only) upon and subject to the trusts, powers, provisions, agreements and declarations hereinafter declared and contained of and concerning the same and the Settlor has requested the Trustees to act as the Trustees thereof, which the Trustees have consented to do (as is testified by their being parties to and executing this Deed);

AND WHEREAS in pursuance of the said desire the Settlor has, prior to the execution hereof, handed over cash of ₹_______/- (Rupees ____________ only) and a cheque for ₹ __________/- (Rupees _________________ only) to the Trustees and the Trustees have accepted and taken possession of the same and they shall hold the said amount upon the Trusts and with and subject to the powers and provisions hereinafter declared and contained;

NOW THIS DEED OF TRUST WITNESSETH as follows:-

1. The Settlor has conveyed, transferred and assigned to the Trustees, the said amount of ₹ __________/- (Rupees ____________________ only) in cash and ₹ __________/- (Rupees ______________________ only) by cheque.

2. The Trust shall be known as "..................." and may hold assets or carry on business in the same name.

3. The Trustees hereby declare that they the Trustees shall hold and stand possessed of the said property which is referred to as "the Trust property" which expression shall also include cash and any other property and investments of any kind whatsoever into which the same or any part thereof might be

converted, invested or varied from time-to-time or such as may be acquired by the Trustees or come to their hands by virtue of these presents or by operation of law or otherwise howsoever in relation to these presents, upon the Trusts and with and subject to the powers, provisions, agreements and declarations hereinafter declared and contained concerning the same.

4. The Trustees shall hold and stand possessed of the Trust property upon the following trusts, that is to say:–

   (a) To manage the trust premises or Trust Fund and collect and receive the interest, dividend and other income thereof;

   (b) To pay and discharge out of the income of the Trust Fund all costs, charges and expenses for collecting and receiving the income of the Trust Fund and all other assets, charges, expenses and outgoings of and incidental to the Trusts created by these presents and administration thereof;

   (c) To close the accounts of the Trust on the 31st day of March of every year and pay to or accumulate or spend the net income of the Trust among the beneficiaries in the following properties:-

      i) -------- %

      ii) ----------%

5. If either of the beneficiaries dies before the determination of this Trust, his or her share and interest in the Trust shall devolve upon the survivor and in the event of the death of the survivor before the determination of the Trust, it shall devolve upon his legal heirs.

   (a) The income of the Trust shall be credited to the respective accounts of the beneficiaries.

   (b) Any amount withdrawn by the beneficiaries or on their behalf shall be debited to the respective accounts of the beneficiaries.

   (c) The Trustees shall also be entitled to spend any part of the corpus or the amounts credited to the accounts of the beneficiaries for their maintenance, education and medical relief or for any other benefit of the beneficiary concerned and such amounts shall be debited to the respective accounts of the beneficiaries.

(d) The Trust shall be determined when the younger of the beneficiaries attains the age of ...... years or on such earlier date as the Trustees may in their absolute power decide. On the determination of the Trust the corpus of the Trust property shall be divided among the beneficiaries existing at the time according to their shares and if there is no existing beneficiary then to the legal heirs of the beneficiary who dies last.

6. It is hereby agreed and declared that the Trustees herein appointed or to be appointed in future as hereinafter provided shall manage the trust property and for this purpose they shall have full power at all times to sell, convert, transfer or alienate any one or more of the Trust properties and to convert the proceeds thereof in other properties, securities or investments as they may deem fit.

7. The Trustees may receive and accept any donations, gifts or bequests from the Settlor or any other person or persons for the purpose of the Trust. The Trustees may also accept deposits or take loans from any person including the Settlor on such terms and conditions as they may deem fit.

8. Without affecting the generality of the powers, provisions and authorities vested in the Trustees under these presents the Trustees shall have in addition thereto and not in substitution thereof, the following powers and authorities and they shall be entitled to execute all acts, documents and things necessary, ancillary or incidental thereto, that is to say :-

(a) To open bank accounts of the Trust in any bank or banks of repute in the name of the Trust or in the name of any Trustee or Trustees and such bank account may be operated by any one of the Trustees individually.

(b) To borrow money or raise loans and funds required for any purpose, power or provision either directly or indirectly concerned with the objects of this Trust or incidental to these presents from any bank or other person or concern.

(c) To draw, make, accept, endorse, discount, execute or issue promissory notes, bills of exchange and other negotiable instruments.

(d) To purchase, take on lease or sub-lease, leave-and-licence basis, co-operative schemes or any other arrangements or in exchange or hire movable or immovable property including residential flats or commercial units and any rights, benefits or privileges which the trustees may think necessary or convenient.

(e) To construct, develop, maintain, erect, fabricate and alter any building, structures, industrial estates, factories and storage tanks or works of any nature whatsoever necessary or convenient or as the Trustees may think fit.

(f) To sell, improve, manage, develop, exchange, lease, mortgage, pledge, hypothecate, dispose of or turn to account and deal with all or any part of the Trust Fund and premises hereby settled or any part or parts thereof.

(g) To organise agencies or offices or to make any other arrangements necessary for conducting and managing the Trust and to appoint such agents and representatives on their behalf as the Trustees may think fit.

(h) To purchase on ownership or take on rent or compensation residential flats, business premises, industrial sheds or factory premises, godowns or open plots of land and let out the same on leave-and-licence or compensation or warehousing charges or storage charges.

(i) To carry on any business or businesses including that of import or export of any commodities, import and export and banking or enter into partnership or joint ventures or other arrangements with any other person, firm, body corporate, society, federation, association of individuals or otherwise howsoever for carrying on any business or businesses, industries or commercial activities for and on behalf of the Trust and to appoint any one or more Trustees to be partners, representatives or nominees or nominee for and on behalf of the Trust to carry out or implement any such arrangements.

(j) The Trustees shall be entitled to determine whether any money or property shall for the purpose of this Trust be considered as capital or income and whether expenses, outgoings or loans ought to be paid or borne out of the corpus or income and any such determination of the Trustees shall be conclusive.

(k) The Trustees may deposit any documents of title or any other papers or documents or certificates held by them relating to any movable or immovable property or relating to the Trust under these presents with any bank or bankers or any other person, firm, or company whatsoever for safe custody and may pay any such charges payable in respect of such deposits.

(l) The Trustees instead of acting personally, may employ and pay any agents, person or representative including any bank or insurance company to transact any business or to do any act whatsoever in relation to the Trusts of these presents including the receipt and payment of moneys without being liable for loss and shall be entitled to be allowed and be paid all charges and expenses incurred hereby.

(m) The Trustees may from time-to-time appoint on such terms with or without remuneration as they may determine any person or persons subject to the provisions of this Trust and the Trustees shall have powers to pay them salary, wages, emoluments, fees and remuneration.

(n) In the event of the Trustees doing any business or starting an industry or undertaking either themselves or in partnership with others or as joint venture and their incurring any losses thereby, they will be entitled to be reimbursed out of the Trust all losses incurred as well as all costs, charges and expenses incurred by them in starting or defending any proceedings.

(o) The Trustees shall have the power to make investments in movable or immovable property, to give loans on interest or otherwise to purchase shares, debentures and other securities, Government bonds etc and to make any other investments as the Trustees in their sole discretion may deem suitable.

8. In the event of the Trustees purchasing an immovable property or properties out of moneys belonging to the Trust, it shall be lawful for the Trustees to repair, pull down, or rebuild them or construct any other buildings or structures out of the corpus of the Trust Fund and to give such properties on lease or tenancy or leave-and-licence or in any other manner on such terms at such rent or rents and upon such conditions as the Trustees may think fit and to make allowance with tenants and others and the Trustees shall also have the power to

condone breaches of covenants and to accept surrender of lease or tenancy etc. and generally shall have all powers of management of such immovable property or properties as absolute owners without being responsible for loss or damage that may happen thereby and it shall be lawful for the Trustees at any time to sell such immovable properties or property or part or parts thereof or easements rights or privileges exercised or enjoyed in, over, for upon or under such immovable property or properties and upon any such exchange to give or receive money for equality or exchange.

9. The Trustees may make any such sale as aforesaid either by public auction or private contract and may make or agree to any stipulations or provisions as to evidence to title or commencement of title or otherwise to any conditions of sale or contract for sale or exchange and may buy in at any sale by auction and rescind or carry any contract and enter into any new contract for any of the purposes aforesaid without being responsible for any loss. The Trustees may execute assurances and give effectual discharge for any such sale or exchange which they may think proper.

10. In the event of any difference between the Trustees concerning the affairs of the Trust, the decision of the majority of the Trustees shall prevail.

11. The Trust being established hereby shall be irrevocable and no part of the Trust Fund shall in any circumstances whatsoever be paid or lent to or be applied for the benefit of the Settlor. If the Trust fails or is held to be invalid for any reasons, there shall be no resulting trust in favour of the Settlor but the assets of the Trust shall be divided amongst the beneficiaries in the proportion mentioned above.

12. Any Trustee for the time being hereof may at any time retire from the Trust on giving not less than one month's notice in writing of his intention to do so to the other Trustees for the time being hereof and upon expiry of such notice the Trustee giving such notice shall cease to be a Trustee of these presents.

13. Every one of the Trustees for himself doth hereby agree that in the event of his vacation of the office of the Trustee, he shall do all necessary acts, deeds and things for effectively transferring over unto the name/names of the additional Trustees or Trustee the Trust Fund and all costs attending such transfer shall be borne out of the income of the Trust Funds.

14. It shall be always lawful for the Trustees to appoint any additional Trustees or Trustee of these presents and if the Trustees hereby appointed or any of them or any future Trustee or Trustees hereof shall die or remain abroad for more than 2 years continuously or become bankrupt or insolvent or desire to be discharged or refuse or become unfit or incapable to act or if the Trustees shall be desirous of appointing any additional Trustees or Trustee along with them then in and every such case it shall be lawful for the Trustees to appoint a new Trustee or Trustees. Upon any such appointment the number of Trustees of these presents shall at no time be less than two nor more than seven and upon every such appointment, the Trust property and the Trust Fund thereof shall (if and so far as the nature thereof or the other circumstances so require or admit) be transferred so that the same may be vested in the Trustees or Trustee for the time being and every Trustee so appointed may as well before or after such transfer of the Trust property or funds act and/ or assist in the execution of the Trusts and powers of these presents as fully and effectively as if he had been hereby originally constituted as a Trustee hereof. Acceptance in writing by the substituted or additional Trustee or Trustees shall be sufficient to vest the Trust Funds in such Trustees or Trustee.

15. The Trustee will from time to time decide questions arising with respect to the administration of the Trust and may keep a record by way of minutes of work done and resolutions arrived at by them at their meetings convened, or by circular.

16. In case any Trustee, whether present or future, happens to be a professional person he will be entitled to payment of professional fees for work done by him or by a firm in which he is a partner and he shall not be liable to account for any share of profits received by him from the firm.

17. And it is hereby further agreed and declared that the Trustees for the time being of these presents shall be respectively chargeable only for such Trust Funds and the income including money, stocks, funds, shares and securities as they shall respectively actually receive notwithstanding their responsibility and shall be answerable and accountable only for their own acts, receipts, neglects and/or defaults and not for those of the other or others of them nor any banker, broker, auctioneer or agents or any other person or persons into whose hands any Trust Funds or Trust income may be deposited or come nor for lending or any security with less than marketable

title nor for the insufficiency or deficiency of any stocks, funds, shares, securities nor any other loss unless the same shall happen through their own wilful defaults or dishonesty respectively and also that the Trustees or Trustee for the time being of these presents may reimburse themselves or himself and pay and discharge out of the Trust Funds and property all expenses incurred in or about the execution of the Trust or powers of these presents.

18. The Trustees shall have power from time-to-time to make rules and bye-laws relating to their meetings and conduct of the business and otherwise as to the management of the Trust Fund and from time-to-time carry out, alter or add to such rules or bye-laws provided however that such rules or bye-laws are not inconsistent with the terms of these presents.

IN WITNESS WHEREOF the parties hereto have hereunto set and subscribed their respective hands the day and year first hereinabove written.

SIGNED AND DELIVERED by the )
within named SETTLOR )
Mr.___________ )
in the presence of )
SIGNED AND DELIVERED by the )
within named TRUSTEES )
(1)___________________ and )
(2) )
in the presence of )

**e. RELINQUISHMENT/RELEASE**

Relinquishment/release is one of the modes of transfer of property. By way of relinquishment deed, one or more joint owner can give up / relinquish /release his /their share in an immovable property to one or more joint owners. A release of rights in immovable property should be by a written deed and registered. Relinquishment of rights may be with consideration or without consideration.

## RELINQUISHMENT DEED

This Deed of relinquishment is made and executed on this____ day of ______, 20__ by ________________S/o ____________________ and ____________________ Daughter of ____________________ residents of ____________________________ hereinafter called "the EXECUTANTS/RELEASORS.

IN FAVOUR OF

__________________W/o ________________________ resident of ______________________ hereinafter called the "RELEASEE".

WHEREAS ________________________________________ son of Shri. __________________resident of ________________________ ________ was the absolute owner of Entire Second Floor of Freehold Property bearing No. ______________ built on Plot No. _______, in Block No _____

Built on a plot of land measuring ___________, situated at __________________ by virtue of Gift Deed registered as document no. _________ in the office of Sub-Registrar, ____________ (hereinafter called the said portion of the said property).

AND WHEREAS the said _______________________intestate died on ____________ (Death Certificate enclosed) leaving behind the following legal heirs:-

| SL. No. | Names | Age | Relationship | Address |
|---|---|---|---|---|
| I) | | | | |
| II) | | | | |
| III) | | | | |

WHEREAS consequent upon the death of Shri __________________ _________________ 1/3rd share each in the ________________of Freehold property bearing No. _______ built on Plot No. ____

In Block No. _________________, built on a plot of land measuring ___________, situated at ______________________, has devolved upon the above legal heirs.

NOW THIS DEED WITNESSETH AS UNDER :–

Pursuant to their wish, as mentioned above, the Executants/ Releasors out of natural love and affection and without any monetary consideration, hereby wish to release and relinquish their ________ share each in the__________ of Freehold property bearing No. __________ built on Plot no________, in Block No ________, built on a plot of land measuring _________, situated at ________________, in favour of. __________________wife of ___________as mentioned above, and hereby affirm and declare that they and their legal heirs shall have no claim, right, lien or interest in the entire _____________ of the aforesaid property and the same shall vest absolutely in the said. ______________ wife of _________________, the Releasee.

IN WITNESS WHEREOF, the Executants/Releasors and the Releasee have signed this Deed of Relinquishment on the day, month and year first mentioned above in the presence of the following witnesses:-

(-------------------)

RELEASEE

(-------------------)

EXECUTANTS/RELEASORS

WITNESSES:–

1.

2.

**f. Settlement Deed**

A Settlement is any non-testamentary disposition, in writing, of immovable property made by one person (known as the 'settlor') in favour of the another person (known as the 'settlee').

So, when there is absolute and instantaneous transfer of interest to beneficiary and where there is absolute or complete disinvestment of right, title, interest of executants on date of execution, it is Settlement.

Settlement is like a gift and can be effected in favour of parents, spouse, children, grandchildren and between brothers and sisters as well.

A family settlement is an agreement where family members mutually work out how a property should get distributed among themselves. All the parties should be related to each other and have a claim to a share of the disputed property. The latter need not be limited to real estate, but can also cover movable assets like jewellery or money in bank accounts. A family settlement is usually used to settle common property or joint property that the family owns as opposed to individual or self-acquired property.

According to Section 17 of the Indian Registration Act, a family settlement that purports to assign immovable property must be mandatorily registered or the deed would be invalid. A stamp duty is applicable on such deeds and the amount would depend on the value of the property involved.

**DEED OF FAMILY SETTLEMENT**

This Deed of Family Settlement made at ________ on this _________ day of ________ 20__, between the ________, (name of person), s/o ________ (father's name) and residing at ________ hereinafter referred to as the "PARTY OF THE FIRST PART" (which expression shall unless it is repugnant to the context mean and include his legal representatives, executors, administrators and assigns)

AND

(i) _____________, wife of _______________, (ii) _____________ s/o _______________, (iii) ____________ d/o __________________

hereinafter referred to as the "PARTY OF THE SECOND/THIRD PART/ FOURTH PART" (which expression shall unless it is repugnant to the context mean and include his legal representatives, executors, administrators and assigns)

Hereinafter together referred to as "OTHER PARTIES"

WHEREAS:

The parties herein are members of the same family and they are related to each other. The PARTY OF THE FIRST PART is the senior member of the family. The PARTY OF THE SECOND PART is his wife. The PARTY OF THE THIRD PART is his son. The PARTY OF THE FOURTH PART is his daughter.

Prior to execution of these presents the parties have been enjoying the following immovable and movable properties jointly:

1. (Details of movable property)

2. (Details of immovable property)

The parties are of the opinion that the properties can no longer be held in common so the parties herein have decided and mutually agreed to divide the properties amicably without any litigation or dispute. The parties are desirous of executing a deed of family settlement of the properties mentioned hereinabove among themselves in the manner agreed below.

NOW THEREFORE IN CONSIDERATION OF THE MUTUAL OBLIGATIONS AND UNDERTAKINGS CONTAINED HEREIN, THIS DEED WITNESSETH AS FOLLOWS:

1. The PARTY OF THE FIRST PART herein is allotted the SCHEDULE 'A' mentioned property.
2. THE PARTY OF THE SECOND PART herein is allotted the SCHEDULE 'A' mentioned property.
3. The PARTY OF THE THIRD PART herein is allotted the SCHEDULE 'B' mentioned property.
4. The PARTY OF THE FOURTH PART herein is allotted the SCHEDULE 'C' mentioned property.

AND THE PARTIES HEREBY COVENANT that all disputes and differences between the parties with regard to the schedule mentioned properties have been fully and finally settled and in any event no party has any claim against the other on any account whatsoever and this deed of family settlement shall not be reopened on any ground whatsoever.

The cost of preparation, execution and registration of these presents shall be borne by the said parties equally. The PARTY OF THE FIRST PART shall retain the original copy of this deed of settlement and the OTHER PARTIES shall retain a true copy of the same signed by all the parties.

Such true copy shall be deemed to be an original deed for all intents and purposes. The Settlement hereby made is free and mutual and it shall be irrevocable and binding on all the parties.

SCHEDULE A

SCHEDULE B

SCHEDULE C

IN WITNESS WHEREOF, the parties hereto have set and subscribed their hands to this writing the day and year first hereinabove written.

PARTY OF THE FIRST PART

PARTY OF THE SECOND PART

PARTY OF THE THIRD PART

PARTY OF THE FOURTH PART

WITNESSES:

1.

2.

**g. Wills**

Will is a legal declaration of the intention of a testator with respect to his property which he desires to be carried into effect after his death - (Section 2(h) of the Indian Succession Act, 1925. A Will is an important document which enables the individual/any living person to rightfully leave his assets and wealth to whomever he chooses to, after his death. In a way a person can ensure that his wishes with respect to his assets and property are followed after his death.

A will made by a Hindu, Buddhist, Sikh or Jain is governed by the provisions of the Indian Succession Act, 1925. However Muslims are not governed by the Indian Succession Act, 1925 and they can dispose of their property according to Muslim Law.

Sec.74 of the Indian Succession Act, 1925 lays down that the use of technical words or terms of art is not necessary in a will but the wording should be such as to clearly indicate the intention of the testator. The Will can be made in any form and language.

**WILL**

I ________, son of ________, Hindu, aged about 60 years and residing at _______________, being of sound body and mind do hereby declare this to be my last Will and testament which I execute at ________ on this day of ________th ________ ________.

1. I hereby revoke all Wills and Testamentary dispositions which I may have herein before made.

2. I bequeath on my death, to ______________________, my title, interests, and all other rights which I have as owner of the residential/commercial property at _________________. I hereby state that he shall be entitled to use and enjoy the said property at his own will after my death.

3. I have ancestral lands in my native village, ________. My son________ and daughter ________ shall take the same with rights of survivorship.

4. I bequeath on my death the following ornaments and jewellery belonging to me to __________ (List of ornaments to be given.)

5. I bequeath on my death, cash balance lying with me at the time of my death to ______________.

6. I bequeath on my death, bank balance lying in my name at Savings/Current Bank Account No. _____ Bank of ______, _________________ Branch, ______ at the time of my death to _______________________________.

7. I bequeath the amounts receivable by me at the time of my death from various parties on various accounts to ___________________.

8. I bequeath the amounts and other valuables owned by me and lying in locker number _________ in my name at Bank_________, (Branch) at the time of my death to ___________.

9. I direct that a sum of rupees ____________________ Only (₹ _____/-) be set apart from my assets at the time of my death and be donated to a charitable trust or persons whose

aim and objective is to provide food, medical assistance, education assistance, etc to needy persons.

10. I direct that before distributing my assets in accordance with this will, all my debts, liabilities and monetary obligations including all testamentary expenses, costs, charges, expenses in respect of probate and other legal charges at the time of my death be met out of my assets.

11. I bequeath all other residuary property, assets and other rights whether or not existing at the time of my death to ___________________.

I further state that my wife, Mrs. _________________ is appointed as the executrix of this Will.

I declare that all other properties possessed by me, in whatever place and in whatever shape are all my self-acquisitions, having been purchased out of my earnings and without recourse to the family properties and I have full testamentary power over them.

IN WITNESS WHEREOF I have hereunto set and subscribed my hand and signature on this __ th day of _____________.

Signature of the Testator

Signed by the above named _________________ in our presence at the said time and each of us, signed his/her name hereunder as attesting witnesses.

Witnesses:

1. I have witnessed and read the aforesaid Will.

   (signature)

2. I have witnessed and read the aforesaid Will.

   (signature)

# XI. INVESTOR GRIEVANCE REDRESSAL

**Taking Care while Investing**

While making an investment the following precautions should be taken

1. Obtain written documents explaining the investment
2. Read and understand such documents
3. Verify the legitimacy of the investment
4. Find out the cost and benefit associated with such investment
5. Assess risk-return profile of the investment
6. Know the liquidity and safety aspects of the investments
7. Ascertain if it is appropriate for your specific goals
8. Compare these details with other investment opportunities available
9. Examine if it fits with other investments you are considering or you have already made
10. Deal only through a SEBI Registered intermediary, where required
11. Seek all clarifications about the intermediary and the investment
12. 12. Explore all the option available to you should some option go wrong. After analysis make the investment

**INVESTOR GRIEVANCES & ARBITRATION (STOCK EXCHANGES) - Source: BSE**

**Investor Grievances**

BSE has established a Department of Investors Services (DIS) to redress investors' grievances. Since its establishment in 1986, the DIS has played a pivotal role in enhancing and maintaining investors' faith and confidence by resolving their grievances either against listed companies or against BSE's Trading Members. The services offered by DIS are as under:

### (a) Investors' Grievances against Listed Companies

Investors' complaints against listed companies are forwarded by BSE to the concerned companies, with a copy sent to the complainant. The investors are advised to inform BSE if the complaints are not resolved within 30 days. If a company fails to redress the complaint within 30 days, BSE sends a reminder to the company. BSE follows-up with the companies and/or their Registrar & Transfer Agents, to resolve such complaints. If the total number of pending complaints against a company exceeds 25 and remain unresolved by the company for more than 45 days, then steps are initiated by BSE to suspend trading in the securities of such company till the complaints are resolved. BSE may also transfer such scrips to, "Z" Group.

A "Z" category company indicates that it has not complied with various provisions of the listing agreement including non-resolution of investors' complaints. Through creation of "Z' category, BSE cautions investors to be more careful in their investments in such companies.

Investors are expected to submit their complaints in the prescribed Complaint format to the concerned Regional Arbitration Centre of BSE, by confirming geographical jurisdiction on the basis of an investor's address. Filing of complaint at the concerned Regional Arbitration Centre will enable the complaint to be processed expeditiously.

Visit of Registrar & Transfer Agents to BSE

BSE regularly organises visits of Registrars & Transfer Agents (RTAs) at its Registered Office to allow Trading Members and investors to have direct interface with them for redress of complaints against companies listed on BSE.

### (b) Investors' Grievances against BSE's Trading Members

Investors are expected to submit their complaints in the prescribed Complaint Form

Effective from 31st January, 2009, the complaint against trading members of the Exchange or Applications for Arbitration should be filed at the concerned Regional Arbitration Centre referred to in column 1 below covering that State or Union Territory of India, referred to in Column 2 below, within which the most recent address/registered office address of the constituent, as duly communicated in writing to the trading member in accordance with law, is located. Provided in respect of a non-resident Indian Constituent, the Seat of Arbitration shall be Regional Arbitration Centre which covers the States and Union Territories given in Column 2, in which lies the address or the Registered Office address, as the case may be, of the trading member, depending upon corporate or non-corporate membership of the trading member. The hearings shall be held in the concerned Regional Arbitration Centre in which the Applicant had duly filed the Application for Arbitration.

| **S. No** | **Column 1** | **Column 2** |
|---|---|---|
| | **Regional Arbitration Centres** | **States and Union Territories covered by the Regional Arbitration Centres** |
| 1 | BSE Ltd.<br>Regional Office – North,<br>7th Floor, Mercantile House<br>K. G. Marg<br>New Delhi-110 001<br>Telephone Number:011-41510481<br>Telefax No.:011-41510480<br>E-mail Id: iscdelhi@bseindia.com; ritesh.kumar@bseindia.com | Delhi, Haryana, Uttar Pradesh, Uttaranchal, Himachal Pradesh, Punjab, Jammu & Kashmir, Chandigarh, Rajasthan |
| 2 | BSE Ltd.<br>Regional Office – East,<br>1st Floor, Kishor Bhavan<br>17, R. N. Mukherji Road<br>Kolkata-700 001<br>Telephone Number:033-22133184,<br>Telefax No.:033-22130530<br>E-mail Id: isc.kolkata@bseindia.com;anirban.guha@bseindia.com | West Bengal, Bihar, Jharkhand, Orissa, Assam, Arunachal Pradesh, Mizoram, Manipur, Sikkim, Meghalaya, Nagaland, Tripura, Chhattisgarh |
| 3 | BSE Ltd.<br>Regional Office – South,<br>4th floor, Exchange Building<br>No. 11, Second Line Beach<br>Chennai-600 001<br>Telephone Number:044-42163999<br>Telefax No.:044-42164999<br>E-mail Id: iscchennai@bseindia.com; s.periyasamy@bseindia.com | Andhra Pradesh, Karnataka, Kerala, Tamil Nadu, Andaman & Nicobar, Lakshadweep, Pondicherry |

| S. No | Column 1 | Column 2 |
|---|---|---|
| 4 | BSE Ltd.<br>Regional Office – West,<br>Department of Investor Services,<br>P J Towers, 1st floor, Dalal Street,<br>Fort, Mumbai-400001.<br>Telephone Number:<br>022-22721233/34<br>Fax No.: 022-22723677<br>E-mail Id: crasto@bseindia.com | Maharashtra, Gujarat, Goa, Daman & Diu, Dadra & Nagar Haveli, Madhya Pradesh |

**JURISDICTION OF COURTS**

The Courts in Mumbai shall have exclusive jurisdiction in respect of all proceedings to which the Exchange is a party, and in respect of all other proceedings, the Courts having jurisdiction over the area in which the respective Regional Arbitration Centre is situated, shall have jurisdiction.

The investors are required by law, to file their grievances and/or Arbitration References in the concerned RAC, which has geographical jurisdiction over the subject matter as above.

The Exchange redresses investors' complaints through arbitration and IGRC mechanism, which are quasi-judicial in nature. The period consumed in redress of complaint through IGRC will not be considered while measuring period of 'limitation' in filing arbitration application provided the complaint and/or arbitration application is/are filed at the concerned Regional Arbitration Centre.

Only those Arbitration References and complaints filed on or after 31st January, 2009 will attract the above provisions.

Further details are available in the Exchange Notice Number 20090323-27 dated 23rd March, 2009.

The complaints of investors against BSE's Trading Member's are forwarded to the concerned Trading Members for resolution within 7 days. In case no reply is received from the Trading Members or the reply received from the Trading Member does not redress the complaint, the same is placed before Investors' Grievances Redressal Committee (IGRC).

BSE provides services of IGRC which, in its meetings, mediates and counsels the disputing parties to find amicable solution, for which the Exchange sends Notice to both parties to remain present before the said IGRC. In cases, where an amicable solution cannot be reached. IGRC suggests the parties to opt for an arbitration if they so desire. It records the final outcome in the matter in the form of minutes, a copy of which is handed over to the parties or mailed to an absent party.

In case a Trading member fails to implement its part of decision recorded in the said minutes of the IGRC, necessary disciplinary action against it is initiated by BSE.

IGRC is a two member Committee, presently constituted by a retired Justice of High Court and a Trading Member. The Exchange has formed separate IGRCs, for each Regional Arbitration Centre to deal with the cases coming within their respective geographical jurisdiction. It will be in the interest of investors to ascertain the concerned Regional Arbitration Centre for filing his/her complaint, since the period consumed in redressal of complaint through IGRC will not be considered while measuring period of 'limitation' in filing arbitration application, if opted, provided the complaint is filed at the concerned Regional Arbitration Centre.

**Investor Protection Fund**

BSE set up an Investor Protection Fund (IPF) on July 10, 1986 to meet the claims of investors against defaulter Members, in accordance with the Guidelines issued by the Ministry of finance, Government of India.

IPF is managed by the Trustees appointed by BSE.

The Fund corpus is created as follows:

The Members contribute ₹ 0.01 per ₹ 1 lakh of gross turnover, which is debited to their General Charges Account.

BSE contributes, on a quarterly basis, 1% of the listing fees collected by it. The entire interest earned by BSE on 1% security deposit kept with it by companies making public/rights issues is credited to the Fund.

As per the SEBI directive, auction proceeds that have been impounded in certain cases where price manipulation/rigging was suspected are transferred to the Fund.

The surplus lying in the account of the defaulters after meeting their liabilities on BSE is released to them after transferring 5% of the surplus amount to this Fund.

As at the end of June 2008 (30-6-2008), the corpus of IPF was ₹ 370 crore.

**Compensation Policy**

The maximum amount presently payable to an investor from this Fund in the event of a default by a Trading Member is ₹ 10.00 lakhs. (This has been progressively raised by BSE from ₹ 10,000 in 1988 to the present level).

The arbitration Award obtained by investors against defaulters are scrutinized by the Defaulters Committee, a Standing Committee constituted by BSE, which may recommend to the Trustees of the Fund for release of the awarded amount or the amount fixed by the said Committee or ₹ 10 lakhs, whichever is lower. After the approval of the Trustees of the Fund, the amount is disbursed to the investors from the Fund.

**Arbitration**

With a view to ensuring speedy and effective resolution of claims, differences and disputes between non-Trading Members and Trading Members and Trading Members inter se, BSE has laid down an arbitration procedure. This procedure is duly embodied in the Rules, Bye-laws and Regulations of BSE, and duly approved by the Government of India/SEBI, under the Securities Contracts (Regulation) Act, 1956.

Effective from 31st January, 2009, the Complaint against trading members of the Exchange or Applications for Arbitration should be filed at the concerned Regional Arbitration Centre referred to in column 1 below covering that State or Union Territory of India, referred to in Column 2 below, within which the most recent address/registered office address of the constituent, as duly communicated in writing to the trading member in accordance with law, is located. Provided that in respect of a non-resident Indian Constituent, the Seat of Arbitration shall be Regional Arbitration Centre which covers the States and Union Territories given in Column 2, in which lies the address or the Registered Office address, as the case may be, of the trading member, depending upon corporate or non-corporate membership of the trading member. The hearings shall be held in the concerned Regional Arbitration Centre in which the Applicant had duly filed the Application for Arbitration.

| S. No | Column 1 | Column 2 |
|---|---|---|
| 1 | **Regional Arbitration Centres** | **States and Union Territories covered by the Regional Arbitration Centres** |
| 2 | BSE Ltd.<br>Regional Office – North,<br>7th Floor, Mercantile House<br>3 K. G. Marg<br>New Delhi-110 001.<br>Telephone Number:011-41510481<br>Telefax No.:011-41510480<br>E-mail Id: iscdelhi@bseindia.com ; ritesh.kumar@bseindia.com | Delhi, Haryana, Uttar Pradesh, Uttaranchal, Himachal Pradesh, Punjab, Jammu & Kashmir, Chandigarh, Rajasthan |
| 3 | BSE Ltd.<br>Regional Office – East,<br>1st Floor, Kishor Bhavan<br>17, R. N. Mukherji Road<br>Kolkata-700 001<br>Telephone Number:033-22133184,<br>Telefax No.:033-22130530<br>E-mail Id: isc.kolkata@bseindia.com;anirban.guha@bseindia.com | West Bengal, Bihar, Jharkhand, Orissa, Assam, Arunachal Pradesh, Mizoram, Manipur, Sikkim, Meghalaya, Nagaland, Tripura, Chhattisgarh |
| 4 | BSE Ltd.<br>Regional Office – South,<br>4th floor, Exchange Building<br>No. 11, Second Line Beach<br>Chennai-600 001<br>Telephone Number:044-42163999<br>Telefax No.:044-42164999<br>E-mail Id: iscchennai@bseindia.com; s.periyasamy@bseindia.com | Andhra Pradesh, Karnataka, Kerala, Tamil Nadu, Andaman & Nicobar, Lakshadweep, Pondicherry. |

| S. No | Column 1 | Column 2 |
|---|---|---|
| 5 | BSE Ltd.<br>Regional Office – West,<br>Department of Investor Services,<br>P J Towers, 1st floor, Dalal Street,<br>Fort, Mumbai-400001<br>Telephone Number:<br>022-22721233/34<br>Fax No.: 022-22723677<br>E-mail Id: crasto@bseindia.com | Maharashtra, Gujarat, Goa, Daman & Diu, Dadra & Nagar Haveli, Madhya Pradesh |

**JURISDICTION OF COURTS**

The Courts in Mumbai shall have exclusive jurisdiction in respect of all proceedings to which the Exchange is a party, and in respect of all other proceedings, the Courts having jurisdiction over the area in which the respective Regional Arbitration Centre is situated, shall have jurisdiction.

The investors are required by law, to file their grievances and/or Arbitration References in the concerned RAC, which has geographical jurisdiction over the subject matter as above

The Exchange redresses investors' complaints through arbitration and IGRC mechanism, which are quasi-judicial in nature. The period consumed in redressal of complaint thru IGRC will not be considered while measuring period of 'limitation' in filing arbitration application provided the complaint and/or arbitration application is/are filed at the concerned Regional Arbitration Centre.

Only those Arbitration References and complaints filed on or after 31st January, 2009 will attract the above provisions.

Further details are available in the Exchange Notice Number 20090323-27 dated 23rd March, 2009.

An in-house arbitration machinery has been provided to decide on :

- Arbitration between Trading Members inter-se; and
- Arbitration between non-Trading Members and Trading Members

All contracts of sale and purchase of securities entered into on the trading platform of BSE are subject to the exclusive jurisdiction of the

Courts in Mumbai save and except as otherwise specifically provided in the rules, Byelaws and Regulations of BSE, and any dispute arising in respect of such contracts shall be referred to and decided by arbitration as provided in the Rules, Byelaws and Regulations of BSE.

The disputing parties, namely the Trading Member and Non-Trading Member are expected to send documentary proof like contract notes, bills, statement of accounts and relevant documentary proof along with the prescribed Arbitration Form, duly filled in.

The Arbitral Tribunal is appointed from the Arbitration Committee appointed for the purpose. The Committee consists of retired Judges of High Court, experienced Solicitors, Advocates, Chartered Accountants, Company Secretaries, and Trading Members. Arbitral Tribunals, consisting of arbitrator/s other than non-trading members are appointed to decide the disputes between the Trading Members and Non-Trading Members.

**i. Arbitration between Trading Members *inter-se* Arbitration Committee**

The provisions relating to Arbitration Committee which deals with arbitration between Trading Members *inter-se* are laid down in the Bye-laws Nos. 282 to 315 of the Rules, Bye-laws and Regulations of BSE.

A three-tier arbitration machinery has been provided at BSE to decide on disputes between the Trading Members. All claims, complaints, differences and disputes between Trading Members arising out of or in relation to any bargains, dealings, transactions or contracts are subject to arbitration and are referred to the Arbitration Committee. The Arbitration Committee is appointed by the BSE's Board of Directors, every year.

**Lower Bench Arbitration**

A Committee of three Arbitrators from the Arbitration Committee is constituted to look into such disputes if the value of the claim exceeds ₹ 25,000, while only one arbitrator hears the dispute if value is less than ₹ 25,000. A Trading Member filing an arbitration reference is required to attach a coupon of ₹ 100.00 along with his arbitration application. Both, the applicant and the respondent or their authorised representatives are required to be present in the arbitration meetings. After hearing the parties, the arbitrators give the Award.

An aggrieved Trading Member, who is not satisfied with the award of the Lower Bench Arbitration Committee, may file an appeal before the Full Bench of the Arbitration Committee within seven days from the date of receipt of the award by him if the principal amount of the claim disallowed by the lower bench to the Appellant exceeds ₹ 1,00,000 or if the amount awarded against the Appellant by the lower bench (without taking into account interest from the date of Award) exceeds ₹ 1,00,000. The Trading Member who desires to file an appeal before the Full Bench of the Arbitration Committee is also required to deposit the amount of the Award or shares as stated in the Lower Bench Award with BSE along with a fee of ₹ 500. The deposit amount/shares are retained with BSE until the case is decided by the Full Bench. In the Full Bench Arbitration meetings, all the members of the Arbitration Committee decide the case of Appeal against the Award of the Lower Bench.

**Appeal before the Board of Directors**

A Trading Member who is not satisfied with the award of the Full Bench Arbitration Committee may prefer an appeal before the Board of Directors if the principal Amount of claim disallowed by the full bench of the Arbitration Committee to the party dissatisfied with the Award exceed ₹ 5,00,000 or if the amount awarded by the full bench against a party dissatisfied with the Award (without taking into consideration interest from the date of Award ) exceeds ₹ 5,00,000. An Appeal should be filed within seven days from the date of the Award of the Full Bench Arbitration Committee by paying a fee of ₹ 750 and also by depositing the Award amount/shares as stated in the Award with the Stock Exchange. The Board of Directors is the final Appellate Authority in the case of arbitration between Trading Members. Beyond this level, there is normally no Appeal provision but in exceptional situations, the Board of Directors may permit a Trading Member to make a further appeal to a Court of Law.

**Patawat Arbitration**

In addition to the three-tier Arbitration machinery as stated above, "Patawat Arbitration", i.e., disputes arising out of physical delivery of securities, is held after every settlement (Patawat). In this arbitration, all members of the Arbitration Committee participate and "Chukadas" (Awards) are given on the objection memos indicating whether documents delivered are "in order" or "not in order". The Trading Members/ their representatives obtain the "Chukadas" in the Patawat Arbitration sessions. The Trading Members are required to affix a coupon of ₹ 50 on the objection memo, stating the nature of the objection as per the "Uniform norms for Good/Bad delivery" Guidelines standardized by SEBI while obtaining the award.

**ii. Arbitration between Non-Trading Members and Trading Members**

Bye-laws Nos. 248 to 281 of the Rules, Bye-laws and Regulations of BSE deal with the procedure regarding arbitration between non-Trading Members and Trading Members of BSE.

An Arbitral Tribunal of one arbitrator is appointed, in case the value of the disputed claim is upto ₹ 10 lakhs, If the value is greater than ₹ 10 lakhs, an Arbitral Tribunal of three arbitrators is appointed. Arbitral Tribunals constituted by only non-trading Member/s are appointed to decide such arbitration references. A party dissatisfied with the Award can file an Appeal with BSE under its Rules, Bye-Laws and Regulations or it can file an Application of the Arbitration and Conciliation Act (TACA) 1996 in the Court of Law. In case appeal is preferred in BSE, the same is decided by the Appellate bench of five Arbitrators and the Award passed by the Appellate Bench is final and binding on the parties subject to challenge u/s. 34 of TACA. The award is enforceable as if it were the decree of the Court on an expiry of a period, provided under section 34(i) of TACA. Bye-laws of BSE provide that an arbitration reference be decided normally within a period of 3 months, from the date on which the Arbitral Tribunal held first hearing on it. However, an extension for a maximum period of 3 months may be considered by, the Exchange.

**Process of Arbitration**

Applications may be filed by non - Trading Members against Trading Members and vice-versa. The disputing parties are advised to refer to ByeLaw 252 of BSE, relating to 'Limitation', while filing an Arbitration application with BSE.

Arbitration application forms (Forms 1, 2, 1A, 2A; as applicable) along with Form 20, Claim Sheet, Check List, Instructions and list of Arbitrators could be downloaded from the BSE's website and is also available free of cost at Regional Arbitration Centres of BSE.

**Documents to be submitted**

Following are the documents to be submitted for filing an application for arbitration:

a. Statement of the case explaining brief history of the relationship of applicant with the respondent, details about the dispute and the nature of transaction/s and bifurcation of the claim amount into claim on account of genuine delivery based transaction and square off transaction/s.

b. Contract Notes pertaining to the transaction in dispute

c. Bills issued/received by the applicant

d. Copy of the Statement of Accounts given by the Trading member.

e. Documents pertaining to receipt/delivery of shares

f. Any other documents in support of the claim

g. An accurate list of the documents produced

h. PAN/GIR No. of the applicant

i. Certified copy of the Balance Sheet of the applicant showing the dues

j. Copy of acknowledgement of the latest Income Tax Return

There are various forms for Arbitration proceedings depending upon whether the claim amount is up to ₹ 10 lakhs or is above ₹ 10 lakhs.

**In case of claims up to Rs. 10 lakhs,** the applicant proposes the names of three Arbitrators and respondent gives consent to any one of them and such person consented by the respondent acts as an Arbitrator in the matter. In case the respondent fails to consent or refuses to consent to any of the proposed Arbitrators, the Managing Director, and Chief Executive Officer of BSE as per Rules, Bye-laws and Regulations of BSE, appoints the Arbitrator in the matter. In such cases, a sum of ₹ 3,970.80 (being the institution fee of ₹ 1,000.00, arbitration fees of ₹ 2,250.00, Clerkage of ₹ 250.00, stamp paper of ₹ 100.00 and Service Tax @ 10.30%) is charged to the applicant and arbitration fee of Rs. 2,757.50 (being arbitration fee of ₹ 2,250.00, Clerkage of ₹ 250.00 and Service Tax @ 10.30%) is charged to the respondent.

In case of claims above ₹ 10 lakhs,an Arbitral Tribunal of three Arbitrators is appointed; one each by an applicant, respondent and the Managing Director and Chief Executive Officer of BSE under its Rules, Bye-Laws and Regulations. If parties or any of the parties authorize/s BSE to appoint an Arbitrator on his/her/their behalf or if the parties or any of the parties fail/s to appoint the Arbitrator/s, the Managing Director and Chief Executive Officer of BSE, appoints the Arbitrator/s on their behalf. In such cases, a sum of ₹ 8,934.30 (being the institution fee of ₹ 1,000.00, arbitration fees of ₹ 6,750.00, Clerkage of ₹ 250.00, cost of stamp paper of ₹ 100.00 and Service Tax @ 10.30%) is charged to the applicant and arbitration fee of ₹ 7,721.00 (being arbitration fee of ₹ 6,750.00, Clerkage of ₹ 250.00 and Service Tax @ 10.30%) is charged to the respondent.

A copy of the documents filed by the applicant along with Forms 3, 4 and 5/3A, 4A and 5A (as applicable) is sent by BSE to the respondent advising him/her/them to submit the details of counter claim, if any, consent to the proposed arbitrator/appointment of arbitrator (as applicable), payment of arbitration fees (as applicable). Both parties are intimated by BSE regarding the appointment of arbitrators.

Subsequently, Notice of Hearing is sent to the parties. The hearings are then arranged as decided by the Arbitrators. Minutes of every hearing is prepared and taken on record. Advocates may appear on behalf of each party after taking permission from the Arbitral Tribunal.

As per the provisions of Bye-law 254 of the Rules, Bye-laws and Regulations of BSE, "the Arbitral Tribunal shall make the award within three months from the date of entering upon the reference or within an extended time, which if approved by the Managing Director and Chief Executive Officer of BSE, shall not be more than three months.. The award has to be a speaking award. Exparte awards are also given. The final award is taken on stamp paper of ₹ 100 and signature/s of Arbitrator/s are obtained on the final award. The award is forwarded to the applicant as well as to the respondent.

Any party to the arbitration, within 15 days from the date of receipt of Award, may request the Arbitral Tribunal to correct any computational/ arithmetical/clerical/typographical/any error or to give an interpretation of a specific point or part of the Award or to make an additional Award as to claims presented in the Arbitration proceedings, but omitted in the Award.

**Appeal provision in the Bye-laws pertaining to Non-Trading Member v/s Trading Member Arbitration**

**Time Limit** : Appeal against the Award of the arbitrators is to be filed within 15 days from the date of receipt of the award. However if a party is unable to file an appeal within the specified period the appeal should be accompanied by an application supported by affidavit setting forth the facts on which the appellant relies to satisfy the Appeal Bench in respect of causes for the delay. The Appeal Bench may, on sufficient cause being shown for the delay, condone the delay.

**Deposit** : A party appealing against an award is required to deposit with the Exchange, the amount or securities (or value thereof) due under the Award, if the award has been passed against him. This amount is deposited with an understanding that the said amount shall be released to the party in whose favor the Appeal is decided, if the same is not challenged in the Court under the provisions of TACA.

**Fees for Appeal** : A party appealing against an award is required to pay the necessary appeal fees, which at present is, ₹ 18,309.80 which includes arbitration fees of ₹ 15,000.00, institution fee of ₹ 1,000.00, Clerkage of ₹ 500.00, Stamp paper of ₹ 100.00 and Service Tax @ 10.30%).

**Appeal Memo** : A party desiring to prefer an appeal against an award of the Arbitrator(s) is required to submit seven sets of Memorandum of Appeal (Form 12) mentioning clearly therein the grounds of objections to the Award appealed from along with copies of relevant documents.

Appeal Bench : The Appeal filed by a party against an award will be heard and decided by an Appeal Bench of five Arbitrators, appointed by the Managing Director and Chief Executive Officer of BSE. The Appeal Bench decides the appeal expeditiously as far as possible within one month of the filing of the Appeal.

**SETTLEMENT OF AWARDS**

If an Award is given against a Trading Member of BSE and the Trading Member fails to implement the Award, a show cause notice is issued by BSE to the Trading Member. If the matter is still not resolved, it is placed before the Disciplinary Action Committee (DAC) and Board of Directors of BSE for suitable directions in the matter, including declaring the trading member, a defaulter.

Unless challenged by either of the parties, an arbitration award becomes a decree on an expiry of three months from the date on which it is received by the party and a decree can be executed through a competent court of law.

## DEFAULTER RELATED MATTERS

An Award against a defaulter Trading Member, is placed before the Defaulters' Committee (DC). The awarded amount or the amount fixed by the DC or ₹ 10,00,000 whichever is lower, is given from the BSE's Investor Protection Fund.

Assets of a Trading Member comprises of the following :

1. Securities to be received by the Trading Member for the settlement
2. Membership security deposit (in terms of cash, Fixed Deposit Receipts, securities lying with BOI Shareholding Limited)
3. Fixed Deposit collected from a Trading Member for the construction of the BSE's buildings
4. Car parking deposit.
5. Bad Deliveries claimed by the Trading Member (who is subsequently declared defaulter), when rectified by the respective Trading Member. When a Trading Member is declared a defaulter, the DC clubs all these assets and disburses the same priority wise as given below. Liabilities of a defaulter arise only out of those transactions which are carried out at BSE.

### Priority of Disbursement

Once a Trading Member has been declared a defaulter, his liabilities are settled in the following order of priority :

1. Dues of the Trade Guarantee Fund.
2. Dues to SEBI, BSE, and Clearing House, as decided by DC.
3. Trading Members who have obtained arbitration awards against the defaulter in respect of Bad Delivery claims.
4. Non-Trading Members who have obtained arbitration awards against the defaulter.
5. Dues to the Investor Protection Fund (IPF).

Only in case the 1st preference in the above mentioned list is satisfied fully, the Committee proceeds towards the 2nd preference in the list, and so on. In case the 1st preference has been fully satisfied and the remaining assets are not sufficient to satisfy the 2nd preference fully, the 2nd preference is satisfied on a pro-rata basis, and so on. In case, a Court of Law declares the defaulter as adjudicated insolvent, all the above claims stand at par.

**INVESTOR GRIEVANCES & ARBITRATION (STOCK EXCHANGES) - Source: NSE**

**Registering complaints with NSE**

1. In case of complaint against a trading member (TM) / registered sub-broker, whom do I address the complaint to?

   You should address the complaint to the Mumbai Office or the Regional Offices of NSE based on the dealing office where the deals were executed as given below:

| S. No | State in which Dealing office of the trading member is located | Complaint to be addressed to |
|---|---|---|
| 1 | Maharashtra, Gujarat, Goa, Daman, Diu, Dadra & Nagar Haveli, Madhya Pradesh | **MUMBAI:**<br>National Stock Exchange of India Ltd.<br>'Exchange Plaza', C-1, Block G, Bandra-Kurla Complex, Bandra (East), Mumbai-400 051<br>Tel. No: (022) 2659 8190<br>Fax No : (022) 2659 8191 |
| 2 | Delhi , Haryana, Uttar Pradesh, Uttaranchal, Himachal Pradesh, Punjab, Jammu & Kashmir, Chandigarh, Rajasthan | **DELHI** :<br>National Stock Exchange of India Ltd. 4th Floor, Jeevan Vihar Building, Parliament Street, New Delhi-110 001<br>Tel No : (011) 2334 4313<br>Fax No: (011) 2336 6658 |
| 3 | West Bengal, Bihar, Jharkhand, Orissa, Assam, Arunachal Pradesh, Mizoram, Manipur, Sikkim, Meghalaya, Nagaland, Tripura, Chhattisgarh | **KOLKATA:**<br>National Stock Exchange of India Ltd. 1st Floor, Park View Apartments, 99, Rash Behari Avenue, Kolkata-700 029.<br>Tel No : (033) 24631802 1805 24631809 1812<br>Fax No : (033) 24631791/ 1806 |

| S. No | State in which Dealing office of the trading member is located | Complaint to be addressed to |
|---|---|---|
| 4 | Andhra Pradesh, Karnataka, Kerala, Tamilnadu, Andaman & Nicobar, Lakshadweep, Pondicherry | **CHENNAI:**<br>National Stock Exchange of India Ltd.<br>2nd floor, Ispahani Centre, Door No 123-124, Nungambakkam High Road, Chennai-600 034<br>Tel No : (044) 2833 2500<br>Fax No.: (044) 2833 2510/ 2521 |

NSE also provides a facility for registering complaints online. For more information, visit the website of NSE: www.nseindia.com under the link 'INVESTORS'

**2. In case of a complaint against a company traded on NSE, whom should I address the complaint to?**

All complaints in respect of companies should be addressed to:

Investor Services Cell (ISC)
National Stock Exchange of India Ltd.
'Exchange Plaza', C-1, Block G,
Bandra-Kurla Complex, Bandra (East),
Mumbai-400 051
Tel. No: (022) 2659 8190
Fax No: (022) 2659 8191
e-mail address: ignse@nse.co.in

**3. What complaints are taken up for redressal by the ISC?**

Investor Services Cell of the Exchange deals with the complaints of investors against the Trading Members of the Exchange or against the listed companies. Investors could lodge their complaints in the format prescribed by the Exchange along with the supporting documents either by registering their complaints in electronic mode through their website www.nseindia.com or may send in their complaints to the nearest investor service centre.

Generally, the complaints of following nature are taken up for resolution by the Exchange.

**Complaints against Exchange Members**

Capital Markets/ Futures & Options Segment:

1. Non-Issuance of the Documents by the Trading Member
2. Non-receipt of funds/securities
3. Non-receipt of margin/security deposit given to the Trading Member
4. Non-Receipt of Corporate Benefit (dividend/interest/bonus etc.)
5. Auction value/close out value received or paid
6. Execution of Trades without Consent
7. Excess Brokerage charged by Trading Member/Sub-broker
8. Non-receipt of credit balance as per the statement of account
9. Non-Receipt of Funds/Securities kept as margin
10. Excess Brokerage Charged (other than on Option Premium)

**Complaints against Listed Companies**

1. Public/Further offerings: Complaint regarding non-receipt of...
    a. Allotment Advice, securities allotted, refund order
    b. Interest on delay in Redemption/Refund Amount
    c. Sale Proceeds of Fractional Entitlement
    d. Composite Application Form (CAF) for Rights offer Rights for (CAF) Application
    e. Securities purchased through a Rights Offer
    f. Letter of offer for Buyback
2. Corporate Actions: Complaint regarding non-receipt of... Dividend
    a. Interest on Debentures, Bonds or other Debt Instruments

b. Securities on account of a Bonus/De-merger/Merger/Stock Split

c. Redemption Amount

3. Transfer of Securities: Complaint regarding non-receipt of... Securities after Dematerialisation

   a. Securities after Transfer/Transmission

   b. Duplicate Certificate relating to Securities

4. Miscellaneous: Complaint regarding non-receipt of copy of the Annual Reports

**4. What complaints are not taken up for redressal by the ISC?**

The Investor Services Cell of the Exchange would not be in a position to deal with certain types of complaints. An Illustrative list of nature of complaints that would not be handled by Investor Services Cell are as under:

**Complaints against Exchange Members**

1. Complaints in respect of transactions which are already subject matter of Arbitration proceedings
2. Complaint involving payment of funds and transfer of securities to entities other than Trading Member
3. Claims for mental agony/harassment and expenses incurred for pursuing the matter with the ISC
4. Claim for notional loss, opportunity loss for the disputed period or trade
5. Complaints pertaining to trades not executed on the Trading System of the Exchange
6. Claims of sub-broker/authorised persons for private commercial dealings with the trading member
7. Claims relating to transactions which are in the nature of loan or financing which are not within the framework defined by the Exchange
8. Claims which are relating to entities/activities which are not regulated by Exchange

**Against a Company:**

1. Complaints pertaining to securities not listed on the Exchange
2. Complaints for refund of postal charges, telephone expenses and miscellaneous charges
3. Compensation for mental agony, harassment
4. Notional loss due to delay in receipt of shares sent for transfer or after IPO
5. Complaints which fall outside the purview of the listing agreement and not related to the Exchange
6. Pledge and assignment of shares
7. Inability of complainant to establish ownership of security.

**5. Is there any specified form for lodging the complaint?**

Investors are requested to use the following forms:

- Investor Complaint Form – TM for lodging complaints against trading members/registered sub-brokers and
- Investor Complaint Form - CO for complaints in respect of companies traded on NSE.

These forms are available on the website of NSE: www.nseindia.com under the link 'INVESTORS'.

**Investor Protection Fund**

**1. What is the Investor Protection Fund (IPF) and when is it used?**

The IPF is maintained by NSE to make good investor claims, which may arise out of non-settlement of obligations by the trading member, who has been declared defaulter/expelled, in respect of trades executed on the Exchange. The IPF is utilised to settle claims of such investors where the trading member through whom the investor has dealt has been declared a defaulter or expelled by the Exchange. Payments out of the IPF may include claims arising on account of non-payment of funds, credit balance by the defaulter /expelled member or non-receipt of securities purchased by the investor through the trading member or non-receipt of securities or fund provided as margin by the investor to the trading member, who has been declared a defaulter/expelled member.

The maximum amount of claim payable from the IPF to the investor (where the TM through whom the investor has dealt is declared a defaulter) is ₹ 11 lakhs.

## ARBITRATION

**1. What is "Arbitration"?**

**Ans.** Arbitration is a quasi-judicial process of settlement of disputes between Trading Member, investor, clearing member, sub-brokers etc. Arbitration aims at quicker legal resolution for the disputes. When one of the parties feels that the complaint has not been resolved satisfactorily either by the other party or through the complaint resolution process of the Exchange, the parties may choose the route of arbitration.

**2. Who can apply for arbitration?**

**Ans.** One of the parties to the dispute who wants legal remedy for resolving dispute could apply for arbitration. In other words investor, sub-broker, trading member or clearing member can apply for arbitration.

**3. What are the different forms/documents required to be submitted while applying for arbitration?**

**Ans.** Lists of documents that are required to be submitted are provided below.

| ***S. No*** | ***Forms/Document*** | ***Purpose*** |
|---|---|---|
| | **Mandatory** | |
| 1 | Form no. I | Application for arbitration |
| 2 | Form no. II | For providing Arbitrator preference in descending order |
| 3 | Statement of Case | Brief description of the case date wise, the basis of arriving at the claim amount and relief sought through arbitration. |
| 4 | Cheque/Pay Order/ Demand Draft | Towards cost of arbitration. |

| S. No | Forms/Document | Purpose |
|---|---|---|
| | **Additional Documents *** | |
| 5 | Statement of Accounts | In case of dispute for funds/ securities |
| 6 | Copies of the relevant Contract Notes & Bills | Relevant to the matter or as per the direction given by the arbitrator |

* In case investor does not have additional documents at the time of making application, same may be submitted during the course of arbitration.

**4. How do I obtain arbitration application forms, if I wish to apply for Arbitration?**

**Ans.** Arbitration application forms are available on Exchange website at *http://www.nseindia.com/content/assist/asst_arb_forms.*zip and applicant may download the same and use the form for making application. Alternatively, investors may request for forms by sending an email to ignse@nse.co.in along with the complete postal address, so that the forms can be mailed to them.

**5. Where can investor file arbitration against the trading member?**

**Ans.** The application for arbitration has to be filed at the Regional Arbitration Centre (RAC) viz. Mumbai, Delhi, Kolkata or Chennai covering the state in which the Constituent ordinarily resides.

| S. No | Seats of Arbitration – Regional Arbitration Centres (RACs) | States covered by the RAC |
|---|---|---|
| 1 | DELHI | Delhi , Haryana, Uttar Pradesh, Uttaranchal, Himachal Pradesh, Punjab, Jammu & Kashmir, Chandigarh, Rajasthan |

| ***S. No*** | ***Seats of Arbitration – Regional Arbitration Centres (RACs)*** | ***States covered by the RAC*** |
|---|---|---|
| 2 | KOLKATA | West Bengal, Bihar, Jharkhand, Orissa, Assam, Arunachal Pradesh, Mizoram, Manipur, Sikkim, Meghalaya, Nagaland, Tripura, Chhattisgarh |
| 3 | CHENNAI | Andhra Pradesh, Karnataka, Kerala, Tamilnadu, Andaman & Nicobar, Lakshadweep, Pondicherry |
| 4 | MUMBAI | Maharashtra, Gujarat, Goa, Daman, Diu, Dadra & Nagar Haveli, Madhya Pradesh |

**6. How is arbitrator appointed? For a case, how is the number of Arbitrator determined?**

**Ans.** If the value of claim made by applicant or counter claim made by the other party is less than or equal to ₹ 25 lakh, sole Arbitrator is appointed.

If the value is more than ₹ 25 Lakh, panel of three Arbitrators is constituted.

**7. Who can represent the arbitration matter on behalf of the investor?**

**Ans.** The Investor may attend the arbitration proceedings and defend the matter on his own or authorize a representative to defend the matter. He also has the opportunity to use services of an advocate to represent the matter.

**8. What is a hearing? Are hearings required in all matters?**

Ans. Hearing is a process, wherein the investor and trading member appear before the Arbitrator at the Exchange premises to present their case.

In case the claim amount is less than ₹ 25,000, the Arbitrator may hold hearing to pass the award else he may pass the award based on the documents submitted by both the parties.

If the claim amount is more than ₹ 25,000, Arbitrator holds hearing at the Exchange premises.

**9. What is the time required for completion of arbitration proceedings?**

**Ans.** The arbitrator is required to complete arbitration proceedings within three months from the date of initial (first) hearing and pass the award. However, the period can be extended by three more months to complete the arbitration proceedings and pass the award.

**10. What is an "Award"?**

**Ans.** Award is a judgment passed by the arbitrator which gives decision on dispute, clearly stating the action that the parties have to take.

**11. How is award implemented?**

**Ans.** Award may be passed in favour of investor or trading member. When award is passed in favour of investor, the Exchange ensures implementation of the award.

The trading member may settle the award and confirm the same to the Exchange. In case, trading member fails to settle the award, the award amount is kept aside. On expiry of three months from the date of receipt of award, the award amount is released to the investor if trading member has not challenged the award in court.

If the trading member challenges the award in court, the award amount kept aside is dealt as per the court order.

**12. What if there are errors in the award? Can they be rectified?**

**Ans.** The investor is required to make an application under section 33 of the Arbitration and Conciliation Act, 1996 within thirty days from the receipt of the arbitral award with the Exchange for getting errors rectified. The Exchange forwards a copy of application to the arbitrator for carrying out the correction.

**13. What if investor wants to seek interpretation on a specific point or part of the award?**

**Ans.** The investor is required to make an application under section 33 of the Arbitration and Conciliation Act, 1996 within thirty days from the receipt of the arbitral award with the Exchange for seeking interpretation. The Exchange forwards a copy of application to the arbitrator for giving interpretation on the specific point or part of the award.

**14. What if investor wants an additional award on the claims presented before the Arbitrator but omitted in the award?**

**Ans.** The investor is required to make an application under section 33 of the Arbitration and Conciliation Act, 1996 within thirty days from the receipt of the arbitral award with the Exchange for making an additional award for the claims presented in arbitral proceeding but omitted from the award. The Exchange forwards a copy of application to the arbitrator for giving an additional award.

**15. What if either of the parties is not satisfied with the Award passed by the arbitrator?**

**Ans.** If either of the parties is not satisfied with the Award, the aggrieved party may approach the appropriate court with an application for setting aside the award under section 34 of the Arbitration and Conciliation Act, 1996 within a period of three months from the date of receipt of the Award.

**16. What are the deposits collected towards cost of arbitration? Is it one time, or additional amount is required to be paid towards cost of arbitration?**

**Ans.** The parties are required to deposit the cost of arbitration depending on the claim as under:

| ***S. no.*** | ***Amount of Claim/ Counter Claim (higher amount to be considered)*** | ***Amount of deposit*** |
|---|---|---|
| 1 | Upto ₹ 10 lakhs | ₹ 10,000/- (deposit is taken only from the trading member and not from the investor) |
| 2 | More than ₹ 10 Lakhs but less than or equal to ₹ 25 Lakhs. | ₹ 12,000/- |
| 3 | Above ₹ 25 Lakhs | ₹ 18,000/- |

Additional deposit may be called towards cost of arbitration from the parties depending on the number of hearings held in the matter.

In case the investor files arbitration against issuer (listed companies), he is required to deposit the cost of arbitration even if the claim amount is less than ₹ 10 Lakh.

**17. What will be the status of the complaint filed with Investor Services Cell (ISC), if arbitration is initiated against the trading member?**

**Ans.** Once arbitration proceedings are initiated against the trading member, the complaint filed with the Investor Services Cell (ISC) is treated as closed.

**18. What if arbitration application is not filed within six months from the date of claim, difference or dispute?**

**Ans.** If the arbitration application is not filed within six months from the date of claim, difference or dispute, the matter may suffer on limitation. However, the issue regarding limitation is decided by the arbitrator in the award after considering the submissions made by the parties to arbitration.

**19. Who bears the cost of arbitration? Is there any different approach for a retail investor?**

**Ans.** The Arbitrator decides in the award as to which party should bear the cost of arbitration.

In respect of arbitration matters, where the claim amount is less than ₹ 10 lakhs, the investor is not required to pay the cost of arbitration, the Exchange bears the cost of arbitration on behalf of investor (Investor may be applicant or respondent).

**WHICH ARE THE REGULATORS/AUTHORITIES TO APPROACH FOR OTHER TYPES OF COMPLAINTS?**

The Regulators/authorities whom the investor has to approach for redressal of other types of grievances are given below:

| *S. No* | *Grievances pertaining to* | *Regulators/Authorities* |
|---|---|---|
| 1 | Banks deposits and banking<br>Fixed Deposits with Non-Banking Financial Companies (NBFCs) and other matters pertaining to NBFCs | Reserve Bank of India (RBI)<br>http://www.rbi.org.in |
| 2 | Insurance Companies/Brokers/ Agents/products and Service | Insurance Regulatory and Development Authority of India (IRDA)<br>http://www.irdaindia.org |
| 3 | Manufacturing companies<br>Unlisted companies<br>Mismanagement of companies, financial performance of the company, Annual General Meeting, Annual Report, minority shareholders interest, non-receipt of preferential allotment shares, etc. and corporate actions as per the court order such as mergers, amalgamation, reduction of share capital/par value, etc.<br>Nidhi Companies | Ministry of Corporate Affairs(MCA)<br>http://www.mca.gov.in |
| 4 | Commodities | Forward Markets Commission (FMC)<br>http://www.fmc.gov.in |
| 5 | Pension Fund | Pension Fund Regulatory and Development Authority (PFRDA)<br>http://www.pfrda.org.in |
| 6 | Monopoly and anti-competitive trade practices | Competition Commission of India (CCI)<br>http://www.cci.gov.in |
| 7 | Chit Funds | Registrars of Chit Funds of the concerned state |

| ***S. No*** | ***Grievances pertaining to*** | ***Regulators/Authorities*** |
|---|---|---|
| 8 | Housing Finance Companies | National Housing Bank (NHB) |

*(Note: Addresses and Email Ids of Authorities and Offices referred to above are subject to change. One may refer to the respective websites for updated information on the same)*

# XII. WARNING ALERTS AND WISE INVESTING

**ALERT 1**

**Invest only in fundamentally strong companies**

- Do not go for momentum or penny stocks.
- Invest only in companies with strong fundamentals; these are the ones that will withstand market pressures, and perform well in the long term.
- Equity investments cannot be sold back to the company/ promoters.
- Strong stocks are also liquid stocks.

**ALERT 2**

**Read Carefully**

- Do not gamble away your hard earned money.
- Due diligence is a must.
- Read about the offer. This is an advice difficult to practice with offer documents now running into more than 1000 pages; abridged prospectus too is difficult to read. Yet, read you must, at least sections on risk factors, litigations, promoters, company history, project, objects of the issue and key financial data.

**ALERT 3**

**Follow life-cycle investing**

- You can afford to take greater risks when you are young.
- As you cross 50, start getting out of risky instruments.
- By 55/60, you should be totally out of equity. (You can't afford to lose your capital when you have stopped earning new money). There are better things in life at that age than watch the price ticker on TV!

**ALERT 4**

**Invest in IPO**

- IPOs are a good entry point.

- Remember, IPOs have to be bought; these are not forced upon the investors.
- Due diligence is a must. Must never blindly invest in an IPO.
- Decide whether you are investing in an IPO or in a company. If as an IPO, then exit on listing date. If as a company, then remain invested as you would in a listed stock.
- And use the ASBA process to invest.

**ALERT 5**

**Learn to Sell**

- Most investors buy and then just hold on (Most advice by experts on the media is also to buy or hold, rarely to sell).
- Profit is profit only when it is in your bank (and not in your register or Excel sheet).
- Remember, you cannot maximize the market's profits so don't be greedy.
- Set a profit target, and sell.

**ALERT 6**

**Deal only with registered intermediaries**

- Many unauthorized operators in the market who will lure you with promises of high returns, and then vanish with your money.
- Dealing with registered intermediaries is safer and allows recourse to regulatory action.

**ALERT 7**

**Let not greed make you an easy prey!**

- Many scamsters are roaming around, to exploit your greed.
- Most scams rob small investors.
- Be careful about the entity seeking your money.

**ALERT 8**

**Beware of the media, especially the stock specific advice on electronic media**

- Too many "saints" in the capital market offering free advice!

- In reality, many of these advisers have vested interests.
- Also beware of the get-rich schemes being sold through SMS and emails.

**ALERT 9**

**Don't get taken in by advertisements**

- The job of an advertisement is to make you feel-good.
- Don't get carried away by attractive headlines, appealing visuals, catchy messages.

**ALERT 10**

**Beware of fixed/guaranteed returns schemes**

- Anyone who is offering a return much greater than the bank lending rate is suspicious.
- Remember plantation companies-promised huge returns (in some cases 50% on Day 1)!

**ALERT 11**

**Beware of the grey market premium**

- These are artificial and normally created by the promoter himself.

**ALERT 12**

**Don't get overwhelmed by sectoral frenzies**

- Remember, all companies in a sector are not good. Each sector will have some very good companies, some reasonably good companies and many bad companies.
- Be also wary about companies that change their names to reflect the current sectoral fancy.

**ALERT 13**

**Don't over-depend upon 'comfort' factors like**

- IPO Grading
- Independent Directors

**ALERT 14**

**Don't blindly take decisions based on accounts just because these are audited**

- There is a high incidence of fraudulent accounts and mis-advertising of financial results. Satyam case is a wakeup call.
- Read qualifications and notes to the accounts.
- Look out especially for unusual entries related to party transactions, sundry debtors, subsidiaries' accounts.

**ALERT 15**

**Cheap shares are not necessarily worth buying**

- Do not chase price, chase value.
- Price can be low because the company in fact is not doing well (but hype over the company/sector may induce you).
- Worse, the price can be low because the face value has been split (over 500 companies have split their shares).

Rationale given: make shares affordable to small investors

➢ Not valid as in demat, one can buy even one share

➢ Real purpose: to make shares appear "cheap"

➢ Companies with a share price of ₹ 50 have split 1:10!

**ALERT 16**

**Be wary of companies where promoters issue shares/warrants to themselves**

- Preferential allotments to promoters are almost always made for the benefit of the promoters only. (The fair route should be rights issue).

**ALERT 17**

**Don't be fooled by Corporate Governance Awards/CSR**

- There is a high incidence of fraudulent companies upping their CG and CSR activities.

**ALERT 18**

**Be honest**

- Be honest to yourself as only then you can demand honesty.
- We are very weak investors/no strong investor associations/ take everything lying down.
- Need to form/join strong investor associations and fight for our rights.
- Need to demand disgorgement.

**ALERT 19**

**Invest-don't speculate**

- Don't invest just because a friend has told you that scrip would be a jackpot.
- Speculating in the market is similar to gambling. It's just that such gambling is legal.
- To be a successful investor requires planning, study and discipline.

**ALERT 20**

**Don't leverage on the market**

Leverage trading is for traders in the market. For investors, invest your own funds. Don't borrow and invest in the market. And investment must be a small share of your wealth and not your entire hard earned money.

# XIII. FINANCIAL AND INVESTMENT GLOSSARY

1. **Abatement** - complete removal of an amount due, (usually referring to a tax abatement a penalty abatement or an interest abatement within a governing agency.)

2. **Account** - Formal record that represents, in words, money or other unit of measurement, certain resources, claims to such resources, transactions or other events that result in changes to those resources and claims.

3. **Account Payable** - Amount owed to a CREDITOR for delivered goods or completed services.

4. **Account Receivable** - Claim against a DEBTOR for an uncollected amount, generally from a completed transaction of sales or services rendered.

5. **Accountable Plan** - An accountable plan is any reimbursement or other expense allowance arrangement of an employer that meets all of the following requirements

    i. it provides reimbursements advances or allowances including per diem and meals, to employees for any job related deductible business expense;

    ii. employees must be able to substantiate expenses covered in the plan; (3) employee must return any excess advances or payments.

6. **Accountant** - Person skilled in the recording and reporting of financial transactions.

7. **Accountants' Report** - Formal document that communicates an independent accountant's: (1) expression of limited assurance on FINANCIAL STATEMENTS as a result of performing inquiry and analytic procedures (Review Report); (2) results of procedures performed (Agreed-Upon Procedures Report); (3) non-expression of opinion or any form of assurance on a presentation in the form of financial statements information that is the representation of management (Compilation Report); or Accounting - Recording and reporting of financial transactions, including the origination of the transaction, its recognition, processing, and summarization in the FINANCIAL STATEMENTS.

8. **Accrual Basis** - Method of ACCOUNTING that recognizes REVENUE when earned, rather than when collected. Expenses are recognized when incurred rather than when paid.

9. **Additional Paid in Capital** - Amounts paid for stock in excess of its PAR VALUE or STATED VALUE. Also, other amounts paid by stockholders and charged to EQUITY ACCOUNTS other than CAPITAL STOCK.

10. **Adjusted Basis** - After a taxpayer's basis in property is determined, it must be adjusted upward to include any additions of capital to the property and reduced by any returns of capital to the taxpayer. Additions might include improvements to the property and subtractions may include depreciation or depletion. A taxpayer's adjusted basis in property is deducted from the amount realized to find the gain or loss on sale or disposition.

11. **Adjusted Gross Income** - Gross income reduced by business and other specified expenses of individual taxpayers. The amount of adjusted gross income affects the extent to which medical expenses, non-business casualty and theft losses and charitable contributions may be deductible. It is also an important figure in the basis of many other individual planning issues as well as a key line item on the IRS form 1040 and required state forms.

12. **Affiliated Company** - Company, or other organization related through common ownership, common control of management or owners, or through some other control mechanism, such as a long-term LEASE.

13. **Agency Fund** - Fund consisting of ASSETS where the holder agrees to remit the assets, income from the assets, or both, to a specified beneficiary in due course or at a specified time.

14. **Alternative Dispute Resolution** - An alternative to formal litigation which includes techniques such as arbitration, mediation, and a non-binding summary jury trial.

15. **American Depository Receipts (ADRs)** - Receipts for shares of foreign company stock maintained by an intermediary indicating ownership.

16. **Amortization** - Gradual and periodic reduction of any amount, such as the periodic write-down of a BOND premium, the cost of an intangible ASSET or periodic payment Of MORTGAGES or other DEBT.

17. **Analytical Procedures** - Substantive tests of financial information which examine relationships among data as a means of obtaining evidence. Such procedures include: (1) comparison of financial information with information of comparable prior periods; (2) comparison of financial information with anticipated results (e.g., forecasts); (3) study of relationships between elements of financial information that should conform to predictable patterns based on the entity's experience; (4) comparison of financial information with industry norms.

18. **Annual Report** - Report to the stockholders of a company which includes the company's annual, audited BALANCE SHEET and related statements of earnings, stockholders' or owners' equity and cash flows, as well as other financial and business information.

19. **Annuity** - Series of payments, usually payable at specified time intervals.

20. **Anti-dilution** - Condition that may increase the computation of EARNINGS PER SHARE (EPS) or decrease loss per share solely because of the inclusion of COMMON STOCK equivalents, such as STOCK OPTIONS, WARRANTS, convertible DEBT or convertible PREFERRED STOCK, nomination or selection of the independent AUDITORs.

21. **Assembly of Financial Statements** - The providing of various accounting or data-processing services by an accountant, the output of which is in the form of financial statements ostensibly to be used solely for internal management purposes.

22. **Assertion** - Explicit or implicit representations by an entity's management that are embodied in financial statement components and for which the AUDITOR obtains and evaluates evidential matter when forming his or her opinion on the entity's financial statements.

23. **Asset** - An economic resource that is expected to be of benefit in the future. Probable future economic benefits obtained as a result of past transactions or events. Anything of value to which the firm has a legal claim. Any owned tangible or intangible object having economic value useful to the owner.

24. **Account** - A record of financial transactions; usually refers to a specific category or type, such as travel expense account or purchase account.

25. **Accountant** - a person who is trained to prepare and maintain financial records.

26. **Accounting** - a system for keeping score in business

27. **Accounting period** - the period of time over which profits are calculated. Normal accounting periods are months, quarters, and years (fiscal or calendar).

28. **Accrual basis, system, or method** - an accounting system that records revenues and expenses at the time the transaction occurs, not at the time cash changes hands. If you buy a coat and charge it, the store records or accrues the sale when you walk with the coat, not when you pay your bill. Cash basis accounting is used by individuals. Accrual basis accounting is used by most businesses.

29. **Accrued expenses, accruals** - an expense which has been incurred but not yet paid for. Salaries are a good example. Employees earn or accrue salaries each hour they work. The salaries continue to accrue until payday when the accrued expense of the salaries is eliminated.

30. **Aging** - a process where accounts receivable are sorted out by age (typically current, 30 to 60 days old, 60 to 120 days old, and so on.) Aging permits collection efforts to focus on accounts that are long overdue.

31. **Amortize** - to charge a regular portion of an expenditure over a fixed period of time. For example if something cost Rs.100 and is to be amortized over ten years, the financial reports will show an expense of Rs.10 per year for ten years. If the cost were not amortized, the entire Rs.100 would show up on the financial report as an expense in the year the expenditure was made.

32. **Appreciation** - an increase in value. If a machine cost Rs.1,000 last year and is now worth Rs.1,200, it has appreciated in value by Rs. 200.

33. **Assets** - things of value owned by a business. An asset may be a physical property such as a building or an object such as a stock certificate, or it may be a right, such as the right to use a patented process.

34. **Audit** - a careful review of financial records to verify their accuracy.

35. **Bad debts** - amounts owed to a company that are not going to be paid. An account receivable becomes a bad debt when it is recognized that it won't be paid. Sometimes, bad debts are written off when recognized. This is an expense. Sometimes, a reserve is set up to provide for possible bad debts. Creating or adding to a reserve is also an expense.

36. **Balance sheet** - a statement of the financial position of a company at a single specific time (often at the close of business on the last day of the month, quarter, or year.) The balance sheet normally lists all assets on the left side or top while liabilities and capital are listed on the right side or bottom. The total of all numbers on the left side or top must equal or balance the total of all numbers on the right side or bottom. A balance sheet balances according to this equation: Assets = Liabilities + Capital

37. **Bond** - a written record of a debt payable more than a year in the future. The bond shows amount of the debt, due date, and interest rate.

38. **Book value** - total assets minus total liabilities. (See also net worth.) Book value also means the value of an asset as recorded on the company's books or financial reports. Book value is often different than true value. It may be more or less.

39. **Breakeven point** - the amount of revenue from sales which exactly equals the amount of expense.

40. Breakeven point is often expressed as the number of units that must be sold to produce revenues exactly equal to expenses. Sales above the breakeven point produce a

41. profit; below produces a loss.

42. **Bad Debt** - All or portion of an ACCOUNT, loan, or note receivable considered to be uncollectible.

43. **Backdating** - Exercise price is based on a lower share price prior to the option grant date. The practice of marking a document with a date that precedes the actual date. ii) Example – Option is approved by the board permits the stock to be priced based upon the lowest price in the past 30 days-permits options to be in the money when issued. Options are suppose to be issued at option price that is neutral at time of issuance. iii) May not be illegal if clearly communicated to shareholders (2) No documents forged (3) Reflected in earnings of the company

44. **Balance Sheet** - Basic FINANCIAL STATEMENT, usually accompanied by appropriate DISCLOSURES that describe the basis of ACCOUNTING used in its preparation and presentation of a specified date the entity's ASSETS, LIABILITIES and the EQUITY of its owners. Also known as a STATEMENT OF FINANCIAL CONDITION.

45. **Bankruptcy** - Legal process, governed by federal statute, whereby the DEBTS of an insolvent person are liquidated after being satisfied to the greatest extent possible by the DEBTOR'S ASSETS. During bankruptcy, the debtor's assets are held and managed by a court appointed TRUSTEE.

46. **Bequest** - A gift by will of personal property. If the bequest is money to the extent it is paid out of income from property it is taxable to the recipient. Generally bequest value is fair market at the date of the decedent's death.

47. **Board of Directors** - Individuals responsible for overseeing the affairs of an entity, including the election of its officers. The board of a CORPORATION that issues stock is elected by stockholders.

48. **Bond** - One type of long-term PROMISSORY NOTE, frequently issued to the public as a SECURITY regulated under federal securities laws or state BLUE SKY LAWS. Bonds can either be registered in the owner's name or are issued as bearer instruments.

49. **Book Value** - Amount, net or CONTRA ACCOUNT balances, that an ASSET or LIABILITY shows on the BALANCE SHEET of a company. Also known as CARRYING VALUE.

50. **Boot** - The non- technical term used by some to describe any cash or other property that is received in exchange of property that would be otherwise non-taxable.

51. **Budget** - Financial plan that serves as an estimate of future cost, REVENUES or both.

52. **Business Combinations** - Combining of two entities. Under the PURCHASE METHOD OF ACCOUNTING, one entity is deemed to acquire another and there is a new basis of accounting for the ASSETS and LIABILITIES of the acquired company. In a POOLING OF INTERESTS, two entities merge through an exchange of COMMON STOCK and there is no change in the CARRYING VALUE of the assets or liabilities.

53. **Business Segment** - Any division of an organization authorized to operate, within prescribed or otherwise established limitations, under substantial control by its own management.

54. **Bylaws** - Collection of formal, written rules governing the conduct of a CORPORATION'S affairs (such as what officers it will have, what their responsibilities are, and how they are to be chosen). Bylaws are approved by a corporation's stockholders, if a stock corporation, or other owners, if a non-stock corporation. (See GOVERNING DOCUMENTS.) Top of Page

55. **Cafeteria Plan** - A benefit plan maintained by an employer for the benefit of the employees under which each participant has the opportunity to select the benefits they desire. Certain minimum choices and non-discriminatory rules apply.

56. **Call Loan** - Loan repayable on demand. Also known as DEMAND LOAN.

57. **Callable Instrument** - BOND which accords an issuer the right to redemption before it is due.

58. **Cap** - To limit. Capital - ASSETS intended to further production. The amount invested in a PROPRIETORSHIP, PARTNERSHIP, or CORPORATION by its owners.

59. **Capital Gain** - Portion of the total GAIN recognized on the sale or exchange of a non-inventory asset which is not taxed as ORDINARY INCOME. Capital gains have historically been taxed at a lower rate than ordinary income.

60. **Capital Stock** - Ownership shares of a CORPORATION authorized by its ARTICLES OF INCORPORATION. The money value assigned to a corporation's issued shares. The BALANCE SHEET account with the aggregate amount of the PAR VALUE or STATED VALUE of all stock issued by a corporation.

61. **Capitalized Cost** - Expenditure identified with goods or services acquired and measured by the amount of cash paid or the market value of other property, CAPITAL STOCK, or services surrendered. Expenditures that are written off during two or more accounting periods.

62. **Capitalized Interest** - INTEREST cost incurred during the time necessary to bring an ASSET to the condition and location for its intended use and included as part of the HISTORICAL COST of acquiring the asset.

63. **Capitalized Lease** - LEASE recorded as an ASSET acquisition accompanied by a corresponding LIABILITY by the LESSEE.

64. **Capital Projects Funds** - Funds used by a not-for-profit organization to account for all resources used for the development of a land improvement or building addition or renovation.

65. **Carryovers** - Provision of tax law that allows current losses or certain tax credits to be utilized in the tax returns of future periods.

66. **Cash Basis** - Method of bookkeeping by which REVENUES and EXPENDITURES are recorded when they are received and paid.

67. **Cash Equivalents** - Short-term (generally less than three months), highly liquid INVESTMENTS that are convertible to known amounts of cash.

68. **Cash Flows** - Net of cash receipts and cash disbursements relating to a particular activity during a specified accounting period.

69. **Casualty Loss** - Any loss of an asset due to fire storm act of nature causing asset damage from unexpected or accidental force. Generally it is deductible regardless of whether it is business or personal.

70. **Certificate of Deposit (CD)** - Formal instrument issued by a bank upon the deposit of funds which may not be withdrawn for a specified time period. Typically, an early withdrawal will incur a penalty.

71. **Certified Financial Planner (CFP)** - Individual who is trained to develop and implement financial plans for individuals, businesses, and organizations, utilizing knowledge of income and estate tax, investments, risk management analysis and retirement planning. CFPs are certified after completing a series of requirements that include education, experience, ethics and an exam. CFPs are not regulated by a governmental authority.

72. **Certified Internal Auditor (CIA)** - Internal AUDITOR who has satisfied the examination requirements of the Institute of Internal Auditors.

73. **Certified Management Accountant (CMA)** - An accreditation conferred by the Institute of Management Accountants that

indicates the designee has passed an examination and attained certain levels of education and experience in the practice of accounting in the private sector.

74. **Certified Public Accountant (CPA)** - ACCOUNTANT who has satisfied the education, experience, and examination requirements of his or her jurisdiction necessary to be certified as a public accountant.

75. **Claim for Refund** - A refund is not automatically mailed if one is due. A taxpayer, whether business or individual, must file a request on a form. It must also be filed within the timeframe allotted or the refund may be lost. An individual can claim a refund back to whatever year it was due but it will only be paid three years back or less.

76. **Clean Opinion** - AUDIT opinion not qualified for any material scope restrictions nor departures from GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP). Also known as UNQUALIFIED OPINION.

77. **Closed-End Mutual Fund** - MUTUAL FUND with a fixed number of shares outstanding that may be bought or sold.

78. **Collateral** - ASSET provided to a CREDITOR as security for a loan.

79. **Collateralized Mortgage Obligation (CMO)** - SECURITY whose cash flows equal the difference between the cash flows of the collateralizing ASSETS and the collateralized obligations of a securitized TRUST. Characteristics of CMO residuals vary greatly and can be extremely complex in nature.

80. **Combined Financial Statement** - FINANCIAL STATEMENT comprising the accounts of two or more entities.

81. **Comfort Letter** - Letter provided by a company's independent public accountant to an underwriter when the underwriter has a DUE DILIGENCE responsibility regarding financial information included in an offering statement.

82. **Common Stock** - CAPITAL STOCK having no preferences generally in terms of dividends, voting rights or distributions.

83. **Company Level Controls** - Controls that exist at the company level that have an impact on controls at the process, transaction, or application level.

84. **Comparative Financial Statement** - FINANCIAL STATEMENT presentation in which the current amounts and the corresponding amounts for previous periods or dates also are shown.

85. **Compensatory Balance** - Funds that a borrower must keep on deposit as required by a bank.

86. **Compilation** - Presentation of financial statement data without the ACCOUNTANT'S assurance as to conformity with GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP).

87. **Compliance Audit** - Review of financial records to determine whether the entity is complying with specific procedures or rules.

88. **Compound Interest Principles** - Interest computed on principal plus interest earned in previous periods.

89. Current Assets are those assets that can be expected to turn into cash within a year or less. Current assets cash, marketable securities, accounts receivable, and inventory.

90. **Comprehensive Income** - Change in EQUITY of a business enterprise during a period from transactions and other events and circumstances from sources not shown in the income statement. The period includes all changes in equity except those resulting from INVESTMENTS by owners and distributions to owners.

91. **Conservatism** - An investment strategy aimed at long-term capital appreciation with low risk; moderate; cautious; opposite of aggressive behavior; show possible losses but wait for actual profits. Concept which directs the least favorable effect on net income.

92. **Consolidated Financial Statements** - Combined FINANCIAL STATEMENTS of a parent company and one or more of its subsidiaries as one economic unit.

93. **Consolidation** - BUSINESS COMBINATION of two or more entities that occurs when the entities transfer all of their NET ASSETS to a new entity created for that purpose.

94. **Constructive Receipt** - A taxpayer is considered to have received the income even though the monies are not in hand, it may have been set aside or otherwise made available. An example is interest on a bank account.

95. **Contingent Liability** - Potential LIABILITY arising from a past transaction or a subsequent event.

96. **Continuing Operations** - Portion of a business entity expected to remain active.

97. **Control Deficiency** - This exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

98. **Control Risk** - Measure of risk that errors exceeding a tolerable amount will not be prevented or detected by an entity's internal controls.

99. **Controls Tests** - Tests directed toward the design or operation of an internal control structure policy or procedure to assess its effectiveness in preventing or detecting material mis-statements in a financial report.

100. **Convertible Stock** - Stock that may be exchanged for other SECURITIES of the issuer.

101. **Corporation** - Form of doing business pursuant to a charter granted by a state or federal government. Corporations typically are characterized by the issuance of freely transferable

     CAPITAL STOCK, perpetual life, centralized management, and limitation of owners' LIABILITY to the amount they invest in the business.

102. **Cost Accounting** - Procedures used for rationally classifying, recording, and allocating current or predicted costs that relate to a certain product or production process.

103. **Cost Recovery Method** - METHOD OF REVENUE RECOGNITION which recognizes profits after costs are completely recovered. Generally used only when the total amount of collections is highly uncertain. In tax, the ACCOUNTING METHOD used to depreciate ASSETS.

104. **Credit** - Entry on the right side of a DOUBLE-ENTRY BOOKKEEPING system that represents the reduction of an ASSET or expense or the addition to a LIABILITY or REVENUE. (See DEBIT.)

105. **Credit Agreement** - Arrangement in which one party borrows or takes possession in the present by promising to pay in the future.

106. **Credit Balance** - BALANCE remaining after one of a series of bookkeeping entries. This amount represents a LIABILITY or income to the entity. (See BALANCE.)

107. **Creditor** - Party that loans money or other ASSETS to another party.

108. **Current Asset** - ASSET that one can reasonably expect to convert into cash, sell, or consume in operations within a single operating cycle, or within a year if more than one cycle is completed each year.

109. **Current Liability** - Obligation whose LIQUIDATION is expected to require the use of existing resources classified as CURRENT ASSETS, or the creation of other current liabilities.

110. **Current Value** - (1) Value of an ASSET at the present time as compared with the asset's HISTORICAL COST. (2) In finance, the amount determined by discounting the future revenue stream of an asset using COMPOUND INTEREST PRINCIPLES.

111. **Capital** - money invested in a business by its owners. On the bottom or right side of a balance sheet. Capital also refers to buildings, machinery, and other fixed assets in a business. A capital investment is an investment in a fixed asset with a long-term use.

112. **Capitalize** - to capitalize means to record an expenditure on the balance sheet as an asset, to be amortized over the future. The opposite is to expense. For example, research expenditure can be capitalized or expensed. If expensed, they are charged against income when the expenditure occurs. If capitalized, the expenditure is charged against income over a period of time usually related to the life of the products or services created by the research.

113. **Cash** - money available to spend now.

114. **Cash flow** - the amount of actual cash generated by business operations, which usually differs from profits shown.

115. **Discounted options** – options that have an exercise price that is less than fair value on the date of grant.

116. **Death Benefit** - Amounts received under a life insurance contract and paid by reason of the death of the insured. (Although most death benefits are paid at termination of life, certain plans now pay accelerated death benefits while

the insured is still alive, i.e.: an AIDS patient might possibly receive accelerated death benefit)

117. **Debit** - Entry on the left side of a DOUBLE-ENTRY BOOKKEEPING system that represents the addition of an ASSET or expense or the reduction to a LIABILITY or REVENUE. (See CREDIT.)

118. **Debit Balance** - BALANCE remaining after one or a series of bookkeeping entries. This amount represents an ASSET or an expense of the entity.

119. **Debt** - General name for money, notes, BONDS, goods or services which represent amounts owed.

120. **Debt Security** - Document which is evidence of an obligation or LIABILITY.

121. **Debt Service Fund** - Fund whose PRINCIPAL or INTEREST is set aside and accumulated to retire DEBT.

122. **Debtor** - Party owing money or other ASSETS to a CREDITOR.

123. **Decedent** - Individual who has died.

124. **Defalcation** - To misuse or embezzle funds.

125. **Default** - Failure to meet any financial obligation. Default triggers a CREDITOR'S rights and remedies identified in the agreement and under the law.

126. **Defeasance** - Annulment of a contract or deed; a clause within a contract or deed that provides for annulment.

127. **Deferred Charge** - Cost incurred for subsequent periods which are reflected as ASSETS.

128. **Deferred Income** - Income received but not earned until all events have occurred. Deferred income is reflected as a LIABILITY.

129. **Deferred Income Taxes** - ASSETS or LIABILITIES that arise from timing or measurement differences between tax and accounting principles.

130. **Deficit** - Financial shortage that occurs when LIABILITIES exceed ASSETS.

131. **Demand Loan** - Loan repayable on demand. Also known as a CALL LOAN.

132. **Dependent Care Expenses** - Qualified child care expenses will allow a taxpayer this computed credit against tax. The amounts can be found on the individual forms as the limitations and computation may change each tax year.

133. **Depletion** - Method of computing a deduction to ACCOUNT for a reduction in value of extractable natural resources.

134. **Deposit Method** - Related to the sales of real estate, under this method the seller does not recognize any profits, does not record a note RECEIVABLE, and continues to reflect the property and related DEBT in the seller's FINANCIAL STATEMENTS, recording the buyer's initial investment and subsequent payments as a deposit.

135. **Depreciation** - Expense allowance made for wear and tear on an ASSET over its estimated useful life. (See ACCELERATED DEPRECIATION and STRAIGHT-LINE DEPRECIATION.)

136. **Derivatives** - Financial instruments whose value varies with the value of an underlying asset (such as a stock, BOND, commodity or currency) or index such as interest rates. Financial instruments whose characteristics and value depend on the characterization of an underlying instrument or asset.

137. **Detection Risk** - Risk that the AUDITOR will not detect a material misstatement.

138. **Disbursement** - Payment by cash or check.

139. **Disclaimer of Opinion** - Statement by an AUDITOR indicating inability to express an opinion on the fairness of the FINANCIAL STATEMENTS provided and the reason for the inability. The auditor is required to disclaim depending on the limitation in scope.

140. **Disclosure** - Process of divulging accounting information so that the content of FINANCIAL STATEMENTS is understood.

141. **Discontinued Operations** - Portion of a business that is planned to be or is discontinued.

142. **Discount** - Reduction from the full amount of a price or DEBT.

143. **Discount Rate** - Rate at which INTEREST is deducted in advance of the issuance, purchasing, selling, or lending of a financial instrument. Also, the rate used to determine the CURRENT VALUE, or present value, of an ASSET or income stream.

144. **Discounted Cash Flow** - Present value of future cash estimated to be generated.

145. **Discretionary Trust** - Arrangement in which the TRUSTEE has the authority to make INVESTMENT decisions and has control over investments within the framework of the TRUST instrument.

146. **Dissolution** - Termination of a CORPORATION.

147. **Distribution Expense** - Expense of selling, advertising, and delivery of goods and services.

148. **Distributions** - Payment by a business entity to its owners of items such as cash ASSETS, stocks, or earnings.

149. **Dividends** - Distribution of earnings to owners of a CORPORATION in cash, other ASSETS of the corporation, or the corporation's CAPITAL STOCK.

150. **Documentation Completion Date** - A complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date.

151. **Double-Entry Bookkeeping** - Method of recording financial transactions in which each transaction is entered in two or more accounts and involves two-way, self-balancing posting. Total DEBITS must equal total CREDITS.

152. **Dual Dating** - Dating of the ACCOUNTANTS' or AUDITORS' REPORT when a subsequent event disclosed in the FINANCIAL STATEMENTS occurs after completion of the field work but before issuance of the report. For example, "January 3, 19xx, except for Note x, as to which the date is March 10, 19xx."

153. **Due Date** - Each governing agency and its forms scheduled reporting and most importantly payments have a required due date. It is this date that if most files timely may result in a penalty, fine, and commence interest charges.

154. **Due Diligence** - (1) Procedures performed by underwriters in connection with the issuance of a SECURITIES EXCHANGE COMMISSION (SEC) registration statement. These procedures involve questions concerning the company and its business, products, competitive position, recent financial and other developments and prospects. Also performed by others in connection with acquisitions and other transactions. (2) Requirement found in ethical codes that the person governed by the ethical rules exercise professional care in conducting his or her activities.

155. **Depreciation** - an expense that is supposed to reflect the loss in value of a fixed asset. For example, if a machine will completely wear out after ten years of use, the cost of the machine is charged as an expense over the ten year life rather than all at once, when the machine is purchased.

156. **Discounted cash flow** - a system for evaluating investment opportunities that discounts or reduces the value of future cash flow.

157. **Dividend** - a portion of the aftertax profits paid out to the owners of a business as a return on their investment.

158. **Earned Income** - Wages, salaries, professional fees, and other amounts received as compensation for services rendered.

159. **Earned Income Credit** - A refundable tax credit for eligible low income workers, subject to computations based on qualifying children and phase in and phase out income levels.

160. **Earnings Per Share (EPS)** - Measure of performance calculated by dividing the net earnings of a company by the average number of shares outstanding during a period.

161. **Effective Tax Rate** - Total income taxes expressed as a percentage of NET INCOME before taxes.

162. **Employee Benefit Plan** - Compensation arrangement, generally in writing, used by employers in addition to salary or wages. Some plans such as group term- life insurance, medical insurance and qualified retirement plans are treated favourably under the tax law. Most common qualified retirement plans are: (1) defined benefit plans - a promise to pay participants specified benefits that are determinable and based on such factors as age, years of service, and compensation; or (2) defined contribution plans - provide an individual account for each participant and benefits based on items such as amounts contributed to the account by the employer and employee and investment experience. This type includes PROFIT-SHARING PLANS, EMPLOYEE STOCK OWNERSHIP PLANS.

163. **Employee Stock Ownership Plan (ESOP)** - Stock bonus plan of an employer that acquires SECURITIES issued by the plan sponsor.

164. **Encumbrance** - (1) MORTGAGE or other lien on the entity's ASSETS; (2) Anticipated EXPENDITURE; (3) Uncompleted or undelivered portion of a purchase commitment.

165. **Equity** - Residual INTEREST in the ASSETS of an entity that remains after deducting its LIABILITIES. Also, the amount of a business' total assets less total liabilities. Also, the third section of a BALANCE SHEET, the other two being assets and liabilities.

166. **Equity Account** - ACCOUNT in the EQUITY section of the BALANCE SHEET. Includes CAPITAL STOCK, ADDITIONAL PAID IN CAPITAL and RETAINED EARNINGS.

167. **Equity Method of Accounting** - Investors cost basis is adjusted up or down (in proportion to the % of stock ownership) as the investee's retained earnings fluctuation; used for long-term investments in equity securities of affiliate where holder can exert significant influence; 20% ownership or greater is arbitrarily presumed to have significant influence over the investee.

168. **Equity Securities** - CAPITAL STOCK and other SECURITIES that represent ownership shares, or the legal rights to purchase or acquire CAPITAL STOCK.

169. **Error** - Act that departs from what should be done; imprudent deviation, unintentional mistake or omission.

170. **Escrow** - Money or property put into the custody of a third party for delivery to a GRANTEE, only after fulfillment of specified conditions.

171. **Estate Tax** - Tax on the value of a DECENDENT'S taxable estate, typically defined as the decedent's ASSETS less LIABILITIES and certain expenses which may include funeral and administrative expenses.

172. **Estimated Tax** - Amount of tax LIABILITY a taxpayer may expect to pay for the current tax period. Usually paid through quarterly installments.

173. **Estimation Transactions** - Activities that involve management judgments or assumptions in formulating account balances in the absence of a precise means of measurement.

174. **Evidential Matter** - Underlying ACCOUNTING data and other corroborating information that support the FINANCIAL STATEMENTS.

175. **Exchanges** - Transfer of money, property or services in exchange for any combination of these items.

176. **Excise Tax** - Tax or duty on the manufacture, sale, or consumption of commodities.

177. **Exclusions** - Income item which is excluded from a taxpayer's gross income by the INTERNAL REVENUE CODE or an administrative action. Common exclusions include gifts, inheritances, and death proceeds paid under a life insurance contract. Also known as excluded income.

178. **Executor** - Person appointed by a Will to manage a DECENDENT'S estate.

179. **Exemption** - Amount of a taxpayer's income that is not subject to tax. All individuals, TRUSTS, and estates qualify for an exemption unless they are claimed as a dependent on another individual's tax return. Exemptions are also granted to taxpayers for their dependents.

180. **Expenditure** - Payment, either in cash, by assuming a LIABILITY, or by surrendering ASSET.

181. **Experienced Auditor** - An AUDITOR that has a reasonable understanding of audit activities and has studied the company's industry as well as the accounting and auditing issues relevant to the industry.

182. **Extinguishment of Debt** - To get rid of the liability by payment; to bring to an end.

183. **Earnings per share** - a company's net profit after taxes for an accounting period, divided by the average number of shares of stock outstanding during the period.

184. 80 - 20 rule - a general rule of thumb in business that says that 20% of the items product 80% of the action - 20% of product line produces 80% of the sales, 20% of of the customers generate 80% of the complaints, and so on. In evaluating any business situation, look for the small group which produces the major portion of the transactions you are concerned with. This rule is not exactly accurate, but it reflects a general truth, nothing is evenly distributed.

185. **Equity** - the owners' share of a business.

186. **Expenditure** - an expenditure occurs when something is acquired for oneself – an asset is purchased,salaries are paid, and so on. An expenditure affects the balance sheet purchased, salaries are paid, and so on. An expenditure affects the balance sheet when it occurs. However, an expenditure will

not necessarily show up on the income statement or affect profits at the time the expenditure is made. All expenditures eventually show up as expenses,which do affect the income statement and profits. While most expenditures involve the exchange of cash for something, expenses need not involve cash.

187. **Expense** - an expenditure which is chargeable against revenue during an accounting period. An expense results in the reduction of an asset. All expenditures are not expenses. For example,a company buys a truck. It trades one asset - cash - to acquire another asset. An expenditure has occurred but no expense is recorded. Only as the truck is depreciated will an expense be recorded. The concept of expense as different from an expenditure is one reason financial reports do not show numbers that represent spendable cash. The distinction between an expenditure and an expense is important in understanding how accounting works and what financial reports mean. (To expense is a verb. It means to charge an expenditure against income when the expenditure occurs. The opposite is to capitalize.)

188. **Face Value** - Amount due at maturity from a BOND or note.

189. **Factoring** - Selling a RECEIVABLE at a discounted value to a third party for cash.

190. **Fair Market Value** - Price at which property would change hands between a buyer and a seller without any compulsion to buy or sell, and both having reasonable knowledge of the relevant facts.

191. **Fiduciary** - Person who is responsible for the administration of property owned by others. Corporate management is a FIDUCIARY with respect to corporate ASSETS which are beneficially owned by the stockholders and CREDITORS. Similarly, a TRUSTEE is the fiduciary of a TRUST and partners owe fiduciary responsibility to each other and to their creditors.

192. **Filing of Returns** - Taxpayers meeting statutory requirements MUST file various returns on the prescribed forms. And they must be filed timely or the y may not be considered as filed.

193. **Financial Institution** - Organization engaged in any of the many aspects of finance including commercial banks, thrift institutions, investment banks, securities brokers and dealers,

credit unions, investment companies, insurance companies, and REAL ESTATE INVESTMENT TRUSTS.

194. **Financial Statements** - Presentation of financial data including BALANCE SHEETS, INCOME STATEMENTS and STATEMENTS OF CASH FLOW, or any supporting statement that is intended to communicate an entity's financial position at a point in time and its results of operations for a period then ended.

195. **Fiscal Year** - Period of 12 consecutive months chosen by an entity as its ACCOUNTING period which may or may not be a calendar year. Fixed Asset - Any tangible ASSET with a life of more than one year used in an entity's operations.

196. **Floor** - Term used when discussing INVENTORIES. Inventory cannot be valued lower than the "floor" which is the net realizable value of the inventory less an allowance for a normal profit margin.

197. **Fair value** - The amount at which an asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

198. **Forecast** - Prospective FINANCIAL STATEMENTS that are an entity's expected financial position, results of operations, and cash flows.

199. **Foreclosure** - Seizure of COLLATERAL by a CREDITOR when DEFAULT under a loan agreement occurs.

200. **Foreign Corporation** - A corporation which is not organized under the laws of ones territories or states. Taxing of foreign corporations depends on whether the corporation has Nexus or effectively connected income in that state.

201. **Foreign Currency Translation** - Restating foreign currency in equivalent dollars; unrealized gains or losses are postponed and carried in Stockholder's Equity until the foreign operation is substantially liquidated.

202. **Franchise** - Legal arrangement whereby the owner of a trade name, franchisor, contracts with a party that wants to use the name on a non-exclusive basis to sell goods or services, franchisee. Frequently, the franchise agreement grants strict supervisory powers to the franchisor over the franchisee which, nevertheless, is an independent business.

203. **Fraud** - Wilful misrepresentation by one person of a fact inflicting damage on another person.

204. **Future Contract** - Transferable agreement to deliver or receive during a specific future month a standardized amount of a commodity.

     Fixed Assets cannot be quickly turned into cash without interfering with business operations. Fixed assets include land, buildings, machinery, equipment, furniture, and long-term investments.

205. **Fiscal year** - an accounting year than begins on a date other than April 1.

206. Fixed cost - a cost that does not change as sales volume changes (in the short run.) Fixed costs normally include such items as rent, depreciation, interest, unaffected by ups and downs in sales.

207. **Forward loading** – Term used for setting the option grant date to occur after predicted fall in stock price or before predicted stock price increase Terms might involve option to be issued with price to be determined based upon the lowest price as of the issue date or for the next 30 days after the issuance. Grant date does not occur until the conclusion of the 30 day period when the price is known. To determine the price the company needs to look back at the stock price for the last 30 days to determine what the exercise price should be. This is another version of backdating.

208. **Goodwill** - in accounting, the difference between what a company pays when it buys the assets of another company and the book value of those assets. Sometimes, real goodwill is involved - a company's good reputation, the loyalty of its customers, and so on. Sometimes, goodwill is an overpayment.

209. **Gain** – Excess of REVENUES received over costs relating to a specific transaction.

210. **General Partnership** – PARTNERSHIP with no limited partners. (See LIMITED LIABILITY PARTNERSHIP and LIMITED PARTNERSHIP.)

211. **Generally Accepted Accounting Principles (GAAP)** – Conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. The highest level of such principles are set by the FINANCIAL ACCOUNTING STANDARDS BOARD (FASB).

212. **Generally Accepted Auditing Standards (GAAS)** – Standards set by the AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (AICPA) which concern the AUDITOR'S professional qualities and judgment in the performance of his or her AUDIT and in the actual report.

213. **Gift** – A valid transfer of property from one taxpayer to another without consideration or compensation. A gift may be subject to the unified estate and gift transfer tax.

214. **Going Concern** – Assumption that a business can remain in operation long enough for all of its current plans to be carried out.

215. **Going Public** – Activities that relate to offering a private company's shares to the general investing public including registering with the SEC.

216. **Goodwill** – Premium paid in the acquisition of an entity over the fair value of its identifiable tangible and intangible ASSETS less LIABILITIES assumed.

217. **Governing Documents** – Official legal documents that dictate how an entity is operated. The governing documents of a CORPORATION include ARTICLES OF INCORPORATION and BYLAWS; a PARTNERSHIP includes the partnership agreement; a TRUST includes the trust agreement or trust indenture; and an LLC includes the ARTICLES OF ORGANIZATION and OPERATING AGREEMENT.

218. **Grantee** – Person to whom property is transferred.

219. **Grantor** – (1) Person who transfers property. (2) Person who creates a trust.

220. **Greenmail** – Any amount a corporation pays to a shareholder to directly or indirectly buy back its stock.

221. **Gross Income** – The beginning point for the determination of income, including income from whatever sources derived. (Also see ADJUSTED GROSS INCOME.)

222. **Guaranty** – Legal arrangement involving a promise by one person to perform the obligations of a second person to a third person, in the event the second person fails to perform.

223. **Grant date** – The date at which an employer and an employee reach a mutual understanding of the key terms and conditions of a share-based payment award. The

employer becomes contingently obligated on the grant date to issue equity instruments or transfer assets to an employee who renders the requisite service. Awards made under an arrangement that is subject to shareholder approval are not deemed to be granted until that approval is obtained unless approval is essentially a formality (or perfunctory), for example, if management and the members of the board of directors control enough votes to approve the arrangement. Similarly, individual awards that are subject to approval by the board of directors, management, or both are not deemed to be granted until all such approvals are obtained. The grant date for an award of equity instruments is the date that an employee begins to benefit from, or be adversely affected by, subsequent changes in the price of the employer's equity shares.

224. **Head of Household** – An individual entitled to special tax rates that fall midway between single rates and married filing joint rates, if they fit the qualifying profile.

225. **Hedge** – A financial term for a specific type of commodities planning and trading.

226. **Historical cost** – Original cost of an asset to an entity.

227. **Holding Period** – The time in which a taxpayer acquires property and the date on which it is sold.

228. **Improvement** – EXPENDITURE directed to a particular ASSET to improve its performance or useful life.

229. **Imputed Interest** – If no interest or an unrealistic amount of interest is charged in a salve involving certain kinds of deferred payments, then the transaction will be treated as if the realistic rate of interest had been used. The difference between the realistic interest and the interest actually used is referred to as imputed interest.

230. **Income** – Inflow of REVENUE during a period of time. (See NET INCOME.)

231. **Income Statement** – Summary of the effect of REVENUES and expenses over a period of time.

232. **Income Tax Basis** – (1) For tax purposes, the concept of basis determines the proper amount of gain to report when an ASSET is sold. Basis is generally the cost paid for an asset plus the amounts paid to improve the asset less

deductions taken against the asset, such as DEPRECIATION and AMORTIZATION. (2) For accounting purposes, a consistent basis of accounting that uses income tax accounting rules while GENERALLY ACCEPTED

233. **Inheritance** – As distinguished from a BEQUEST or devise, an inheritance is property acquired through laws of descent and distribution from a person who dies without leaving a will. The value of property inherited id excluded from a taxpayers gross income, but if the property inherited produces income it is included in gross income. A taxpayer's basis in inherited property is the fair market value at the time of death.

234. **Initial Public Offering (IPO)** – When a private company goes public for the first time.

235. **Inquiry** – A procedure that consists of seeking information, both financial and non financial, of knowledgeable persons throughout the company. It is used extensively throughout the audit and often is complementary to performing other procedures. Inquiries may range from formal written inquiries to informal oral inquiries.

236. **Insolvent** – When an entity's LIABILITIES exceed its ASSETS.

237. **Instalment** – Partial payment.

238. **Intangible Asset** – Asset having no physical existence such as trademarks and patents.

239. **Interest** – Payment for the use or forbearance of money.

240. **In the Money option** – Option granted with an exercise price below the market price on the grant date

241. **Interim Financial Statements** – FINANCIAL STATEMENTS that report the operations of an entity for less than one year.

242. **Internal Audit** – AUDIT performed within an entity by its staff rather than an independent certified public accountant.

243. **Internal Control** – Process designed to provide reasonable assurance regarding achievement of various management objectives such as the reliability of financial reports.

    Pertain to the maintenance of records that accurately and fairly reflect the transactions and dispositions of the assets of the company. 2. Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the company. 3. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

244. **Internal Rate of Return** – Method that determines the discount rate at which the present value of the future CASH FLOWS will exactly equal investment outlay.

245. **Internet/World Wide Net** – The Internet is the analyses wild west show of computer networks connected together throughout the world. The World Wide Web or WWW, is part of the Internet.

246. **Inventory** – Tangible property held for sale, or materials used in a production process to make a product.

247. **Investment** – EXPENDITURE used to purchase goods or services that could produce a return to the investor.

248. **Involuntary Conversions** – This is a conversion of property where it is in whole or part destroyed, stolen, seized, requisitioned or condemned (or where there is a threat or imminence of requisition or condemnation).

249. Intangible Assets are items such as patents, copyrights, trademarks, licenses, franchises, and other kinds of rights or things of value to a company, which are not physical objects. These assets may be the most important ones a person owns.

250. **Interest** - a charge made for the use of money.

251. **Invested capital** - the total of a company's long-term debt and equity.

252. **Joint Venture** – When two or more persons or organizations gather CAPITAL to provide a product or service. Often carried out as a PARTNERSHIP.

253. **Journal** – Any book containing original entries of daily financial transactions.

254. **Junk Bonds** – DEBT SECURITIES issued by companies with higher than normal credit risk. Considered "non-investment grade" bonds, these SECURITIES ordinarily yield a higher rate of interest to compensate for the additional risk.

255. **Key Employee** – For purposes of rules that apply to top heavy plans, a key employee:

256. **Key Person Insurance** – Business-owned life insurance contract typically on the lives of principal officers that normally provides for guaranteed death benefits to the company and the accumulation of a cash surrender value.

257. **Kiting** – Writing checks against a bank account with insufficient funds to cover them, hoping that the bank will receive deposits before the checks arrive for clearance.

258. **Lease** – Conveyance of land, buildings, equipment or other ASSETS from one person (LESSOR) to another (LESSEE) for a specific period of time for monetary or other consideration, usually in the form of rent.

259. **Leasehold** – Property INTEREST a LESSEE owns in the leased property.

260. **Ledger** – Any book of accounts containing the summaries of debit and credit entries.

261. **Lessee** – Person or entity that has the right to use property under the terms of a LEASE.

262. **Lessor** – Owner of property, the temporary use of which is transferred to another (LESSEE) under the terms of a LEASE.

263. **Leveraged Buy Out** – Acquisition of a controlling INTEREST in a company in a transaction financed by the issuance of DEBT instruments by the acquired entity.

264. **Leveraged Lease** – Transaction under which the LESSOR borrows funds to acquire property which is leased to a third party. The property and lease rentals are security for the LESSOR'S indebtedness.

265. **Liability** – DEBTS or obligations owed by one entity (DEBTOR) to another entity (CREDITOR) payable in money, goods, or services.

266. **Limited Liability Partnership** (LLP) – GENERAL PARTNERSHIP which, via registration with an appropriate state authority, is able to enshroud all its partners in limited liability. Rules governing LLPs vary significantly from state to state.

267. **Limited Partnership** – PARTNERSHIP in which one or more partners, but not all, have limited liability to creditors of the partnership.

268. **Liquid Assets** – Cash, cash equivalents, and marketable SECURITIES.

269. **Liquidation** – Winding up an activity by distributing its ASSETS to the appropriate parties and settling its DEBTS.

270. **Long-Term Debt** – DEBT with a maturity of more than one year from the current date.

271. **Loss** – Excess of EXPENDITURES over REVENUE for a period or activity. Also, for tax purposes, an excess of basis over the amount realized in a transaction.

272. **Lower of Cost or Market** – Valuing ASSETS for financial reporting purposes. Ordinarily, "cost" is the purchase price of the asset and "market" refers to its current replacement cost.

273. **Liquid** - having lots of cash or assets easily converted to cash

274. **Management Accounting** – Reporting designed to assist management in decision-making, planning, and control. Also known as Managerial Accounting.

275. **Management's Report** – Management is required to include in its annual report its assessment of the effectiveness of the company's internal control over financial reporting in addition to its audited financial statements as of the end of the most recent fiscal year.

276. **Margin** – Excess of selling price over the unit cost.

277. **Mark-to-Market** – Method of valuing ASSETS that results in adjustment of an asset's carrying amount to its market value.

278. **Marketable Securities** – Stocks and other negotiable instruments which can be easily bought and sold on either listed exchanges or over-the-counter markets.

279. **Matching Principle** – A fundamental concept of basic accounting. In any one given accounting period, you should try to match the revenue you are reporting with the expenses it took to generate that revenue in the same time period, or over the periods in which you will be receiving benefits from that expenditure. A simple example is depreciation expense. If you buy a building that will last for many years, you don't write off the cost of that building all at once. Instead, you take depreciation deductions over the building's estimated useful life. Thus, you've "matched" the expense, or cost, of the building with the benefits it produces, over the course of the years it will be in service.

280. **Material Weakness** – A significant deficiency or combination of significant deficiencies that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

281. **Measurement Date** – The date at which the equity share price and other pertinent factors, such as expected volatility, that enter into measurement of the total recognized amount of compensation cost for an award of share-based payment are fixed

282. **Merger** – BUSINESS COMBINATION that occurs when one entity directly acquires the ASSETS and LIABILITIES of one or more entities and no new corporation or entity is created. (See CONSOLIDATION.)

283. **Mortgage** – Legal instrument evidencing a security interest in ASSETS, usually real estate. Mortgages serve as COLLATERAL for PROMISSORY NOTES.

284. **Mutual Fund** – Investment company which generally offers its shares to the general public and invests the proceeds in a diversified portfolio of SECURITIES. (See CLOSED-END MUTUAL FUND and OPEN-END MUTUAL FUND.) Top of Page

285. **Negative Assurance** – Report issued by an ACCOUNTANT based on limited procedures that states that nothing has come to the accountant's attention to indicate that the financial information is not fairly presented.

286. **Negligence** – The omission to do something which a reasonable man, guided by those ordinary considerations which ordinarily regulate human affairs, would do, or the doing of something which a reasonable and prudent man would not do. Negligence is the failure to use such care as a reasonably prudent and careful person would use under similar circumstances; it is the doing of some act which a person of ordinary prudence would not have done under similar circumstances or failure to do what a person of ordinary prudence would have done under similar circumstances. The term refers only to that legal delinquency which results whenever a man fails to exhibit the care which he ought to exhibit, whether it be slight, ordinary, or great. It is characterized chiefly by inadvertence, thoughtlessness, inattention, and the like, while "wantonness" or "recklessness" is characterized by nalyse ss. The law of negligence is founded on reasonable conduct or reasonable care under all

circumstances of particular care. Doctrine of negligence rests on duty of every person to exercise due care in his conduct toward others from which injury may result.

287. **Net Assets** – Excess of the value of SECURITIES owned, cash, receivables, and other ASSETS over the LIABILITIES of the company.

288. **Net Income** – Excess or DEFICIT of total REVENUES and GAINS compared with total expenses and losses for an ACCOUNTING period. (See INCOME and LOSS.)

289. **Net Lease** – In addition to the rental payment, the LESSEE assumes all property charges such as taxes, insurance, and maintenance.

290. **Net Sales** – Sales at gross invoice amounts less any adjustments for returns, allowances, or discounts taken.

291. **Net Worth** – Similar to EQUITY, the excess of ASSETS over LIABILITIES.

292. **Non-for-Profit Organization/Tax-Exempt Organization** – An incorporated organization which exists for educational or charitable purposes, and from which its shareholders or trustees do not benefit financially. Also called not-for-profit organization.

293. **Non Routine Transactions** – Activities that occur only periodically, the data involved are generally not part of the routine flow of transactions.

294. **No-Par Stock** – Stock authorized to be issued but for which no PAR VALUE is set in the ARTICLES OF INCORPORATION. A STATED VALUE is set by the BOARD OF DIRECTORS on the issuance of this type of stock.

295. **No-Par Value** – Stock or bond that does not have a specific value indicated. (See STATED VALUE.)

296. **Notional** – Value assigned to ASSETS or LIABILITIES that is not based on cost or market (e.g., the value of a service not yet rendered). Top of Page

297. **Net worth** - total assets minus total liabilities. Net worth is seldom the true value of a person or a company.

298. **Objectivity** – Emphasizing or expressing the nature of reality as it is, apart from personal reflection or feelings; independence of mind.

299. **Obligations** – Any amount which may require payment by an entity at a future time.

300. **Open-End Mutual Fund** – MUTUAL FUND that does not have a fixed number of shares outstanding, offers new shares to the public, and buys back outstanding shares at market value.

301. **Operating Agreement** – Agreement, usually a written document, that sets out the rules by which a LIMITED LIABILITY COMPANY (LLC) is to be operated. It is the LLC equivalent of corporate BYLAWS or a PARTNERSHIP agreement.

302. **Operating Cycle** – Period of time between the acquisition of goods and services involved in the manufacturing process and the final cash realization resulting from sales and subsequent collections.

303. **Option** – Right to buy or sell something at a specified price during a specified time period.

304. **Ordinary Income** – One of two classes of income (the other being CAPITAL GAINS) taxed under the INTERNAL REVENUE CODE. Historically, ordinary income is taxed at a higher rate than capital gains.

305. **Organization Expenditures** – The costs of organizing a trade or business or for profit activity before it begins active business. A taxpayer may elect to amortize such expenses for a tern no less than 60 months. If the election is not made then the expenses are not deductible and may only be recovered when the business ceases operation or is sold.

306. **Other Post-Retirement Employee Benefit (OPEB)** – All post-retirement benefits other than pensions, provided by employers to employees.

307. **Opportunity cost** - a useful concept in evaluating alternate opportunities. If you choose alternative A, you cannot choose B, C, or D. What is the cost or loss of profit of not choosing B, C, or D? This cost or loss of profit is the opportunity cost of alternative A. In personal life you may buy a car instead of taking a European vacation. The opportunity cost of buying the car is the loss of the enjoyment of the vacation.

308. **Out of the Money option** – Option granted with an exercise price above the market price.

309. **Paid-in Capital** – Portion of the stockholders' EQUITY which was paid in by the stockholders, as opposed to CAPITAL arising from profitable operations.

310. **Parent Company** – Company that has a controlling interest in the COMMON STOCK of another.

311. **Partnership** – Relationship between two or more persons based on a written, oral, or implied agreement whereby they agree to carry on a trade or business for profit and share the resulting profits. Unlike a CORPORATION'S shareholders, the partnership's general partners are liable for the DEBTS of the partnership.

312. **Par Value** – Amount per share set in the ARTICLES OF INCORPORATION of a CORPORATION to be entered in the CAPITAL STOCKS account where it is left permanently and signifies a cushion of EQUITY capital for the protection of CREDITORS.

313. **Passive Activity Loss** – LOSS generated from activities involved in the conduct of a trade or business in which the taxpayer does not materially participate.

314. **Passive Income** – Includes income derived from such sources as dividends, interest, royalties, rents, amounts received from personal service contracts, and income received as a beneficiary of an estate or trust.

315. **Patronage Dividends** – These dividends are amounts paid by a cooperative to its members and customers based on the quantity or value of business conducted with or for the members during the tax year.

316. **Penalty** – The various government codes contain numerous provisions which impose penalties on a taxpayer (any type of taxpayer) for failure to perform a specific act or omitting vital information on a return.

317. **Pension** – Retirement plan offered by an employer for the benefit of an employee, usually at retirement, through a TRUSTEE who controls the plan ASSETS. (See EMPLOYEE BENEFIT PLAN.)

318. **Personal Financial Planning** – Process for arriving at a comprehensive plan to solve an individual's personal, business, and financial problems and concerns.

319. **Personal Financial Statements** – FINANCIAL STATEMENTS prepared for an individual or family to show financial status.

320. **Personal Property** – Movable property that is not affixed to the land (REAL PROPERTY). Personal property includes tangible

items such as cash, cars and computers, as well as intangible items, such as royalties, patents and copyrights.

321. **Phantom Income** – Income reported on a TAX BASIS for which no cash or financial benefit is realized.

322. **Pledged Asset** – ASSET placed in a TRUST and used as COLLATERAL for a DEBT.

323. **Pooling of Interest** – Used to account for the acquisition of another company when the acquiring company exchanges its voting COMMON STOCK for the voting common stock of the acquired company when certain criteria are met.

324. **Post-Retirement Benefits** – PENSIONS, health care, life insurance and other benefits that are provided by an employer to retirees, their dependents, or survivors.

325. **Preferred Stock** – Type of CAPITAL STOCK that carries certain preferences over COMMON STOCK, such as a prior claim on DIVIDENDS and ASSETS.

326. **Premium** – (1) Excess amount paid for a BOND over its face amount. (2) In insurance, the cost of specified coverage for a designated period of time.

327. **Prepaid Expense** – Cost incurred to acquire economically useful goods or services that are expected to be consumed in the revenue-earning process within the operating cycle.

328. **Present Value** – CURRENT VALUE of a given future cash flow stream, discounted at a given rate.

329. **Principal** – Face amount of a SECURITY, exclusive of any PREMIUM or INTEREST. The basis for INTEREST computations.

330. **Private Placement** – Sales of SECURITIES not involving a PUBLIC OFFERING and exempt from registration pursuant to certain EXEMPTIONS.

331. **Privilege** – A right or immunity granted as a peculiar benefit advantage.

332. **Privity** – An interest in a transaction, contract or legal action to which one is not a party, arising out of a relationship to one of the parties.

333. **Profit Sharing Plan** – DEFINED CONTRIBUTION PLAN characterized by the setting aside of a portion of an entity's profits in participant's accounts.

334. **Pro Forma** – Presentation of financial information that gives effect to an assumed event.

335. **Projection** – Prospective FINANCIAL STATEMENTS that include one or more hypothetical assumptions.

336. **Promissory Note** – Evidence of a DEBT with specific amount due and interest rate. The note may specify a maturity date or it may be payable on demand. The promissory note may or may not accompany other instruments such as a MORTGAGE providing security for the payment thereof. (See DEMAND LOAN.)

337. **Proprietorship** – Business owned by an individual without the limited liability protection of a CORPORATION or a LIMITED LIABILITY COMPANY (LLC). Also known as sole proprietorship.

338. **Pro Rata** – Distribution of an expense, fund, or DIVIDEND proportionate with ownership.

339. **Prospective Financial Information (forecast and projection)** – Forecast: Prospective financial statements that present, to the best of the responsible party's knowledge and belief, an entity's expected financial position, results of operations, and changes in financial position. A financial forecast is based on the responsible party's assumptions reflecting conditions it expects to exist and the course of action it expects to take. Projection: Prospective financial statements that present, to the best of the responsible party's knowledge and belief, given one or more hypothetical assumptions, an entity's expected financial position, results of operations, and changes in financial position.

340. **Proxy** – Document authorizing someone other than the shareholder to exercise the right to vote the stock owned by the shareholder.

341. **Public Offering** – Offering shares to the public.

342. **Puts** – A put is an option to sell a certain number of shares of stock at a stated price within a certain period. The gain or loss on a put is short or long- term depending on the holding period of the stock involved.

343. **Present value** - a concept that compares the value of money available in the future with the value of money in hand today. For example, Rs.78.35 invested today in a 5% savings account will grow to Rs.100 in five years. The concept of present value

is used to analyse investment opportunities that have a future payofff.

344. **Price-earnings (P/E) ratio** - the market price of a share of stock divided by the earnings (profit) per share. P/e ratios can vary from sky high to dismally low, but often do not reflect the true value of a company.

345. **Profit** - the amount left over when expenses are subtracted from revenues.

346. **Ratio Analysis** – Comparison of actual or projected data for a particular company to other data for that company or industry in order to analyse trends or relationships.

347. **Real Estate Investment Trust (REIT)** – Investor-owned TRUST which invests in real estate and, instead of paying income tax on its income, reports to each of its owners his or her pro rata share of its income for inclusion on their income tax returns. This unique trust arrangement is specifically provided for in the INTERNAL REVENUE CODE.

348. **Real Estate Property** – Land and improvements, including buildings and PERSONAL PROPERTY, that is permanently attached to the land or customarily transferred with the land.

349. **Reasonable Assurance** – Management's assessment of the effectiveness of internal control over financial reporting is expressed at the level of reasonable assurance. It includes the understanding that there is a remote likelihood that material misstatements will not be prevented or detected on a timely basis. It is a high level of assurance.

350. **Recapitalization** – An internal reorganization of a corporation including a rearrangement of the capital structure by changing the kind of stock or the number of shares outstanding or issuing stock instead of bonds. It is distinguished from most other types of reorganization because it involves only one corporation and is usually accomplished by the surrender by shareholders of their securities for other stock or securities of a different type.

351. **Receivables** – Amounts of money due from customers or other DEBTORS.

352. **Reconciliation** – Comparison of two numbers to demonstrate the basis for the difference between them.

353. **Redemption Value** – Price to be paid by an ENTITY to retire its BONDS or PREFERRED STOCK.

354. **Red Herring** – "Pre-release" PROSPECTUS offering. An announcement of a future issuance of SECURITIES, given restricted circulation during the waiting period of 20 days or other specified period between the filing of a registration statement with the SEC and the effective date of the statement. A red herring is not an offer to sell or the solicitation of an offer to buy.

355. **Refinancing Agreement** – Arrangement to provide funding to replace existing financing, the most common being a refinance of a home MORTGAGE.

356. **Regulated Investment Company (RIC)** – Commonly called a MUTUAL FUND, this is a domestic corporation that acts as an investment agent for its shareholders by typically investing in government and corporate securities and distributing the DIVIDENDS and INTEREST income earned from such investments. In order to be considered a RIC a CORPORATION must make an irrevocable election tax election in order to be treated as one.

357. **Reinsurance** – Process by which an insurance company obtains insurance on its insurance claims with other insurers in order to spread the risk.

358. **Related Party Transaction** – Business or other transaction between persons who do not have an arm's-length relationship (e.g., a relationship with independent, competing interests). The most common is between family members or controlled entities. For tax purposes, these types of transactions are generally subject to a greater level of scrutiny.

359. **Relevant Assertions** – Assertions that have a meaningful bearing on whether the account is fairly stated.

360. **Repairs** – EXPENDITURES made in order to keep property in good condition but that do not appreciably prolong the life or increase the value of the property.

361. **Replacements** – EXPENDITURES for making good or whole the portions of property that have deteriorated through use or have been destroyed through accident.

362. **Repurchase Agreement (Repos)** – Agreement whereby an institution purchases SECURITIES under a stipulation that the

seller will repurchase the securities within a certain time period at a certain price.

363. **Research and Development (R&D)** – Research is a planned activity aimed at discovery of new knowledge with the hope of developing new or improved products and services. Development is the translation of research findings into a plan or design of new or improved products and services.

364. **Reserve** – ACCOUNT used to earmark a portion of EQUITY or fund balance to indicate that it is not available for expenditure. An obsolete term in the United States. More commonly used in Europe.

365. **Restricted Assets** – Cash or other ASSETS whose use in whole or in part is restricted for specific purposes bound by virtue of contracted agreements.

366. **Restricted Fund** – Fund established to account for assets whose income must be used for purposes established by donors or grantors of such ASSETS.

367. **Restructuring** – Reorganization within an entity. Restructuring may occur in the form of changing the components of CAPITAL, renegotiating the terms of DEBT agreements, etc.

368. **Retained Earnings** – Accumulated undistributed earnings of a company retained for future needs or for future distribution to its owners.

369. **Return on Investment (ROI)** – Ratio measure of the profits achieved by a firm through its basic operations. An indicator of management's general effectiveness and efficiency. The simplest version is the ratio of NET INCOME to total ASSETS.

370. **Revenue Recognition** – Method of determining whether or not income has met the conditions of being earned and realized or is realizable.

371. **Revenues** – Sales of products, merchandise, and services; and earnings from INTEREST, DIVIDEND, rents.

372. **Right to Set-off** – DEBTOR'S legal right, to discharge all or a portion of the DEBT owed to another party by applying against the debt an amount that the other party owes to the debtor.

373. **Risk Management** – Process of identifying and monitoring business risks in a manner that offers a risk/return relationship that is acceptable to an entity's operating philosophy.

374. **Routine Transactions** – Recurring financial activities reflected in the accounting records in the normal course of business.

375. **Retained earnings** - profits not distributed to shareholders as dividends, the accumulation of a company's profits less any dividends paid out. Retained earnings are not spendable cash.

376. **Return on investment (ROI)** - a measure of the effectiveness and efficiency with which managers use the resources available to them, expressed as a percentage. Return on equity is usually net profit after taxes divided by the shareholders' equity. Return on invested capital is usually net profit after taxes plus interest paid on long-term debt divided by the equity plus the long-term debt.

377. **Revenue** - the amounts received by or due a company for goods or services it provides to customers. Receipts are cash revenues. Revenues can also be represented by accounts receivable.

378. **Risk** - the possibility of loss; inherent in all business activities. High risk requires high return. All business decisions must consider the amount of risk involved.

379. **Safe Harbor Rule** – Concept in statutes and regulations whereby a person who meets listed requirements will be preserved from adverse legal action. Frequently, safe harbors are used where a legal requirement is somewhat ambiguous and carries a risk of punishment for an unintended violation.

380. **Sale-Leaseback Transaction** – Sale of property by a seller who simultaneously leases the property back from the purchaser.

381. **Salvage Value** – Selling price assigned to retired FIXED ASSETS or merchandise unsalable through usual channels.

382. **Security** – Any kind of transferable certificate of ownership including EQUITY SECURITIES and DEBT SECURITIES.

383. **Securitization** –Source of financing whereby an entity's ASSETS (typically mortgage loans, lease obligations or other types of RECEIVABLES) are placed in a special purpose vehicle that issues SECURITIES collateralized by such assets.

384. **Security Interest** – Legal interest of one person in the property of another to assure performance of a second person under a contract.

385. **Settlement Method** – Method of ACCOUNTING for SECURITIES whereby transactions are recorded on the date the securities settle by the delivery or receipt of securities and the receipt or payment of cash.

386. **Short Sale** – Sale of an item before it is purchased. A person entering into a short sale believes the price of the item will decline between the date of the short sale and the date he or she must purchase the item to deliver the item under the terms of the short sale.

387. **Short-Term** – Current; ordinarily due within one year.

388. **Significant Deficiency** – A control deficiency or combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process or report external financial data reliably in accordance with GAAP such that there is more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected.

389. **Spinoff** – Transfer of all, or a portion of, a subsidiary's stock or other ASSETS to the stockholders of its parent company on a PRO RATA basis.

390. **Spot Market** – Market for buying and selling commodities or financial instruments for immediate delivery and payment based on the settlement conventions of the particular market.

391. **Spread** – Difference between two prices, usually a buying and selling price.

392. **Standard Deduction** – Individual taxpayers who do not itemize their deductions are entitled to a standard deduction amount by which to reduce ADJUSTED GROSS INCOME in arriving at taxable income. The amount of the standard deduction varies by the type of the taxpayer and changes each year. A schedule of standard deductions is easily found in the instructions for the federal form 1040. Each state may also use a standard deduction format, but the amounts and computations differ from the federal and from state to state. Certain taxpayers may not be entitled to use the standard deduction. An example of this would be a married filing as separate taxpayer. If one taxpayer itemizes then the other is required to by law even if the married filing separate taxpayer is unknowing of what is included on the spouse's separate return. A reason for this might be the prevention of pooling and duplication of deductions.

393. **Start-up Costs** – (1) Costs, excluding acquisition costs, incurred to bring a new unit into production. (2) Costs incurred to begin a business.

394. **Stated Value** – Per share amount set by the BOARD OF DIRECTORS to be placed in the CAPITAL STOCK account upon issuance of NO-PAR VALUE.

395. **Statement of Cash Flows** – A statement of cash flows is one of the basic financial statements that is required as part of a complete set of financial statements prepared in conformity with generally accepted accounting principles. It categorizes net cash provided or used during a period as operating, investing and financing activities, and reconciles beginning and ending cash and cash equivalents.

396. **Stepped Up Basis** – Generally, the basis of property acquired by INHERITENCE, BEQUEST or device from a DECENDANT is the FAIR MARKET VALUE of the property on the date of the decendant's death. Thus if the fair market value is more than the decedent's basis, a taxpayers basis in the property received is stepped-up.

397. **Stock Compensation Plan** – FRINGE BENEFIT that gives employees the option to purchase the employer's stock at a specified price during a specified period.

398. **Stock Option** – Right to purchase or sell a specified number of shares of stock at specified prices and times.

399. **Sales** - amounts received or due for goods or services sold to customers. Gross sales are total sales before any returns or adjustments. Net sales are after accounting for returns and adjustments.

400. **Stock** - a certificate (or electronic or other record) that indicates ownership of a portion of a corporation; a share of stock. Preferred stock promises its owner a dividend that is usually fixed in amount or percent. Preferred shareholders get paid first out of any profit. They have preference. Common stock has no preference and no fixed rate of return. Treasury stock was originally issued to shareholders but has been subsequently acquired by the corporation .Authorized by un-issued stock is stock which official corporate action has authorized but has not sold or issued.

401. **Sunk costs** - money already spent and gone, which will not be recovered no matter what course of action is taken. Bad

decisions are made when managers attempt to recoup sunk costs.

402. **Spring loading** – Timing of option grants to take place before good news or after bad news is released Concerns about insider trading

403. **Stock Rights** – Stock rights are rights issued to stockholders of a CORPORATION that entitle them to purchase new shares of stock in the corporation for a stated price that is often substantially less than the FAIR MARKET VALUE of the stock. These rights may be exercised by paying the stated price, may be sold, or may be allowed to expire or lapse. Stock rights are generally treated as stock DIVIDENDS.

404. **Stock Split** – Increase in the number of shares of a company's COMMON STOCK outstanding that result from the issuance of additional shares proportionally to existing stockholders without additional capital investment. The PAR VALUE of each share is reduced proportionally.

405. **Straight-Line Depreciation** – ACCOUNTING method that reflects an equal amount of wear and tear during each period of an ASSET'S useful life. For instance, the annual STRAIGHT-LINE DEPRECIATION of a $2,500 asset expected to last five years is $500. (See ACCELERATED DEPRECIATION.)

406. **Strike Price** – Price of a financial instrument at which conversion or exercise occurs.

407. **Subsequent Event** – Material event that occurs after the end of the accounting period and before the publication of an entity's FINANCIAL STATEMENTS. Such events are disclosed in the notes to the financial statements.

408. **Swap** – Financial contract in which two parties agree to exchange net streams of payments over a specified period. The payments are usually determined by applying different indices (e.g., interest rates, foreign exchange rates, equity indices) to a NOTIONAL amount. The term notional is used because swap contracts generally do not involve exchanges of PRINCIPAL.

409. **Tangible Asset** – ASSETS having a physical existence, such as cash, land, buildings, machinery, or claims on property, investments or goods in process. (See INTANGIBLE ASSETS.)

410. **Tax** – Charge levied by a governmental unit on income, consumption, wealth, or other basis.

411. **Tax Lien** – ENCUMBRANCE placed on property as security for unpaid taxes.

412. **Tax Shelter** – Arrangement in which allowable tax deductions or EXCLUSIONS result in the deferral of tax on INCOME that would otherwise be payable currently.

413. **Tax Year** – The period used to compute a taxpayer's TAXABLE INCOME is tax year. It is an annual period that is either a calendar year , FISCAL YEAR or fractional part of a year for which the return is made.

414. **Taxable Income** – Taxable income is generally equal to a taxpayer's ADJUSTED GROSS INCOME during the TAX YEAR less any allowable EXEMPTIONS and deductions.

415. **Tenancy-in-Common** – Co-ownership of property. In a valid tenancy-in-common, a deceased co- owner's title passes to his or her heirs without being included in the estate of the deceased co- owner.

416. **Term Loan** – Loan for a specified time period.

417. **Total Gain** – Excess of the proceeds realized on the sale of either INVENTORY or non-inventory goods.

418. **Trade Date** – Date when a SECURITY transaction is entered into, to be settled on at a later date. Transactions involving financial instruments are generally accounted for on the trade date.

419. **Transferred Basis** – A transferred basis is the basis of property in the hands of a transferor, donor or GRANTOR. In this sense a prior owner's basis in the property is transferred to the taxpayer. Transferred basis occurs in the following transactions: GIFTS, transfers in trusts, certain transfers to controlled CORPORATIONS, contributions to PARTNERSHIPS and LIQUIDATING distributions from a corporation.

420. **Transferee Liability** – A person may be held LIABLE for another taxpayer's delinquent taxes if: The transferee received assets of the transferor-taxpayer; and 2. The transferor was INSOLVENT at the time or was rendered insolvent by that transfer or related series of transfers. However the insolvency requirement does not apply to GIFT taxes. The transferee is only liable to the extent of the value of the property received from the transferor. Thus, transferee liability merely provides a means for the IRS to recover any assets the transferor-taxpayer attempts to transfer to avoid paying taxes.

421. **Treasury Bill** – Short-term obligation that bears no INTEREST and is sold at a discount.

422. **Treasury Bond** – Long-term obligation that matures more than five years from issuance and bears INTEREST.

423. **Treasury Note** – Intermediate-term obligation that matures one to five years from issuance and bears INTEREST.

424. **Treasury Stock** – Stock reacquired by the issuing company. It may be held indefinitely, retired, issued upon exercise of STOCK OPTIONS or resold.

425. **Trust** – Ancient legal practice where one person (the GRANTOR) transfers the legal title to an ASSET, called the principal or corpus, to another person (the TRUSTEE), with specific instructions about how the corpus is to be managed and disposed.

426. **Trustee** – Person who is given legal title to, and management authority over, the property placed in a trust.

427. **Unaudited Financial Statements** – FINANCIAL STATEMENTS which have not undergone a detailed AUDIT examination by an independent Chartered Accountant

428. **Unearned Income** – Payments received for services which have not yet been performed.

429. **Unqualified Opinion** – AUDIT opinion not qualified for any material scope restrictions nor departures from GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP). The AUDITOR may issue an unqualified opinion only when there are no identified material weaknesses and when there have been no restrictions on the scope of the auditor's work. Also known as CLEAN OPINION.

430. **Unrestricted Funds** – Resources of a not-for-profit entity that have no restrictions as to use or purpose.

431. **Valuation Allowance** – Method of lowering or raising an object's CURRENT VALUE by adjusting its acquisition cost to reflect its market value by use of a CONTRA ACCOUNT.

432. **Variable Rate Loan** – Loan whose interest rate changes over its life in relation to the level of an index.

433. **Variance** – Deviation or difference between an estimated value and the actual value.

434. **Venture Capital** – Investment company whose primary objective is capital growth. New ASSETS invested largely in companies that are developing new ideas, products, or processes.

435. **Vesting** – Point at which certain benefits available to an employee are no longer contingent on the employee continuing to work for the employer. Top of Page

436. **Warrant** – Option to purchase additional SECURITIES from the issuer.

437. **Wash Sale** – A wash sale occurs if stock or securities are sold at a LOSS and the seller acquires substantially identical stock or SECURITIES 30 days before or after the sale. Stock or securities for this purpose includes contracts or operations to acquire or sell stock or securities. Losses incurred in a wash sale cannot be deducted. It does not matter if the total 60 day period begins in one tax year and ends in another. However, the disallowed loss is not permanently lost. Instead, the basis in the newly acquired stock or securities is the same basis as of the stock or securities sold, adjusted by the difference in price of the stock or securities.

438. **Withholding** – Amount withheld or deducted from employee salaries by the employer and paid by the employer, for the employee, to the proper authority.

439. **Withholding Allowance** – Each taxpayer is allowed to claim a withholding allowance, which exempts a certain amount of wages from being subject to WITHHOLDING. The allowance is designed to prevent too much taxes being withheld from a taxpayers wages and a person can compute this by completing form W-4 and submitting it to their employer.

440. **Working Capital** – Excess of CURRENT ASSETS over CURRENT LIABILITIES.

441. **Working Papers** – (1) Records kept by the AUDITOR of the procedures applied, the tests performed, the information obtained, and the pertinent conclusions reached in the course of the AUDIT. (2) Any records developed by a CERTIFIED PUBLIC ACCOUNTANT (CPA) during an audit.

442. **Work in Progress** – INVENTORY account consisting of partially completed goods awaiting completion and transfer to finished inventory.

443. **Wrap-Around Mortgage** – Second MORTGAGE which conveniently expands the total amount of borrowing by the mortgagor without disturbing the original mortgage.

444. **Write-down** - the partial reduction in the value of an asset, recognizing obsolescence or other losses in value.

445. **Write-off** - the total reduction in the value of an asset, recognizing that it no longer has any value. Write-downs and write-offs are non-cash expenses that affect profits.

446. **Yield** – Return on an INVESTMENT an investor receives from DIVIDENDS or INTEREST expressed as a percentage of the cost of the SECURITY.

447. **Yield to Maturity** – Rate of return on a SECURITY to its maturity, giving effect to the stated interest rate, accrual of discount, or AMORTIZATION of PREMIUM.

448. **Zero-Coupon Bond** – BOND on which the holder receives only one payment at maturity which includes both PRINCIPAL and INTEREST from issuance to maturity.

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