WEALTH MANAGEMENT - FREQUENTLY ASKED QUESTIONS

What is Wealth Management?
Wealth Management is an advanced investment advisory discipline that incorporates Financial Planning and Specialist Financial Services.

What is financial planning?
A simple and effective way to plan for your financial future just as you plan for anything else –for a movie by finding out what we like, where is it showing, how will we reach there and what will it cost. In a rapidly changing world, it is necessary to know financially where we are, what are our dreams and how much money is required to realize each dream including financial freedom.

Why is financial planning important? What are the advantages of financial planning (FP)?

To protect yourself and your loved ones against financial risk
To achieve the best possible lifestyle, suitable to your income streams
To plan for the best possible education for your children or buying your dream house
To build up adequate corpus for your long term goals
To be able to retire when you want and as you want

It's important to see if we can achieve the lifestyle we yearn for, such as a dream home, that snazzy car, educating children well or the biggest dream of all to retire early and enjoy life peacefully.

Through FP we are able to see, if though approximately, how much we need to earn, save and invest to realize our dreams & goals. The biggest advantage is that we have control over where every rupee goes, know the value of money and we can make sure that every rupee saved earns more money, thus making money work for us instead of we working for money.

When should one start with financial planning?
Ideal time to start is NOW . Starting young is a big advantage. Many people put off financial planning as they think " I am young and what difference can waiting for a year make " – it can in fact make a big difference!

A 30 your saving 1000 Rs a month until age 65, earning 10% pa, makes 37,96,640 but if this person waited one more year because he was too busy , he would have made only 34,25,390 when he turns 65

Waiting one year would have cost 3, 71,250!!!

How does one get started with financial planning?

Through a simple financial planning worksheet like this, which gives a map for the journey of realizing our dreams.

How do I calculate my net worth?

Simply put, your net worth is all your assets (home, investments, deposits, jewelry, RE) – all your liabilities (outstanding loans on your home, education, credit card debt, personal loan etc)

How do I determine my financial goals?

It's a derivative of what you want in the future such as to own house, a vacation abroad, a new car or simply enough money for retiring peacefully.

With so much uncertainty in the economic climate, what is the use of a plan?

Not planning is not an option anymore, even if the outlook is uncertain. The expenses are actually certain. None of us would want our children to get poor education because we could not afford a better college or live in a rented house when we want a dream home or want to postpone retirement.

What is inflation, and what is its impact on the financial plan?

Inflation is the silent thief which eats the value of your money – without your realizing it. In other words it's the increase in prices that we all talk about. If you have 100 Rs and the inflation rate is 6% you lose 6% every year (to put it other way round you need 106 rupees to buy things that was 100 Rs a year earlier. (Remember how much a movie ticket cost when you were in college and how much it costs now, that is inflation)

So if you put all your money in savings account when inflation is 6% and you earn 3.50% interest, you are losing 2.50% every year – and this is before taxes on the interest.

What is an asset allocation plan (AAP) ?

AAP is about not putting all your eggs in one basket. Remember those retirees who invested all their pension money in chit funds and lost everything or the investors in dot com stocks? AAP is about minimizing risk by spreading the investment across classes so that the risk is diversified, and reduced to some extent.

The major asset classes are

1. Equity – representing highest returns historically with the highest risk
2. Debt – such as FDs, Bonds, Pension / Provident Funds – investment which have a fixed return
3. Cash and Money Market instruments – Primarily used as a reserve for a rainy day. Cash helps in uncertain times, but yields no return. It may be still better to invest in short term investments that have capital guarantee , with some interest
4. Real Estate – Either as a primary home or land / through RE funds
5. Alternate assets – such as commodities like gold, etc

After a plan is developed, what next?

A plan is the first step and should be followed up by actual implementation such as apportioning the available money across the assets, determining where to invest according to AAP, and then doing the actual investments .The plan needs to be then reviewed periodically to see if any changes are required.

What is diversification, and why is it important?

Diversification is spreading of risk across assets such that investment risk is not high.
It's about not putting all your eggs in one basket.

What is tracking and rebalancing?

Tracking is ensuring that the plan is in the right direction – if a year down the line the stock market has moved down and according to the AAP you need to have 40% stocks whereas you have only 30% thanks to the market fall, you may need to add more money to stocks. Tracking is monitoring.

Rebalancing is how we maintain the portfolio balance if our original AAP was
40% equity 60% debt and after a year due to market movements it becomes 35% equity and 65% debt. 5% from debt investments needs to be sold and equity investments bought such that the original AAP is maintained. This ensure that all investors follow the basic rule of investing which is buy low and sell high. Rebalancing the action resulting out of tracking.

How often should I update my plan?

Once a quarter should be fine. It may be useless to check on the portfolio daily for people who diligently follow a plan. The media is either euphoric or depressed so an investor could become negative or elated by short term moves and ignore the long term fundamentals.

Mutual funds

Basics:

What is a Mutual Fund?

A Mutual Fund is an investment that allows investors both big and small access to a well-diversified portfolio of either equities, bonds or other securities. Each investor participates in the gain or loss of the fund. Units are issued and can be redeemed as needed. The fund's Net Asset Value (NAV) is determined each day.

They are companies who receive your money, and then make investments in financial markets as mentioned above. It is an ideal tool for people who want to invest but are put away by the complexities of the markets or the arcane language experts use. The beauty of mutual funds is that anyone with an investible surplus of a few hundred rupees can invest and reap returns.

What are the benefits of investing in Mutual Funds?

Small investments: Mutual funds accepts investments as low as few thousand rupees which is invested across the markets. Such a spread is difficult for an investor to do on his own.

Professionalism : Professionals experience and resources manage the money collected by a mutual fund. They analyse the markets to pick good investments.

Spreading Risk : An investor with a small amount of money would be able to invest in only one or two stocks / bonds, thus increasing risk. However, a mutual fund will spread its risk by investing a number of sound stocks or bonds. A fund normally invests in companies across a wide range of industries, so the risk is spread.

Transparency and interactivity: Mutual Funds provide investors with information on the value of their investments. Mutual Funds also provide complete picture of the investments made by their various schemes and the proportion invested in each asset type.

Liquidity : Open ended funds can be sold back to Mutual Funds at NAV based prices subject to exit loads and close ended funds can be sold at the stock exchanges where they are traded.

Choice : The funds can be picked from a wide array available so that the investor chooses what suits him best according to his risk and return expectation.

Who regulates mutual funds (MFs)?

All the mutual funds are registered with SEBI and they function within the provisions of strict regulations designed to protect the interests of the investor.

Who runs mutual funds?

http://www.amfiindia.com/spages/images/mfconceptorg.gif

In India, MFs are set up as Unit Trusts, A Mutual Fund is run by an Asset Management Company(AMC), overseen by Trustees.

Could I lose money if I invest in mutual funds?
Yes, it is possible. Most Mutual Fund products (except capital guaranteed funds) have underlying assets (Equities, Bonds etc) that fluctuate on a daily basis and hence capital loss due to lower prices of the underlying assets or default on bonds is a possibility. These can to a large extent be mitigated by investing according to an asset allocation plan, having enough exposure to other capital guaranteed investment such as FDs, Government Guaranteed bonds etc.,

What are the tax benefits available for investing in mutual funds?

For Dividends:
Income received in respect of units of a mutual fund specified under Section 10(23D) is exempt from income tax in India and the mutual funds are subject to paying distribution tax in debt-oriented schemes. Hence all the dividends are tax-free in the hands of investors

For Sale of units
Units of a scheme held as a capital asset, for a period of more than twelve months immediately preceding the date of sale, will be treated as a long-term capital asset – thus attracting long-term capital gains tax rate.

In all other cases it would be treated as a short-term capital asset and would attract short-term capital gains tax rate. Hence depending on the period of investments, long-term or short-term capital gains and tax thereon are applicable on redemption

Equity Oriented Schemes

Long Term Capital Gains : Tax Free
Short Term Capital Gains : 15%+ surcharges+ cess

All Other Schemes

Long Term Capital Gains : 20% with indexation or 10% without indexation whichever is less + surcharge + cess

Short Term capital gains : Normal rates applicable to the investor as per his or her tax slab

Security Transaction Tax Rate

1 Purchase of an equity share in a company or a unit of an equity oriented fund, where (a) the transaction of such purchase is entered into in a recognized stock exchange; and (b) the contract for the purchase of such share or unit is settled by the actual delivery or transfer of such share or unit 0.125%

2 Sale of an equity share in a company or a unit of an equity oriented fund, where (a) the transaction of such sale is entered into in a recognized stock exchange; and (b) the contract for the sale of such share or unit is settled by the actual delivery or transfer of such share or unit 0.125%

3 Sale of a derivative, where the transaction of such sale is entered into in a recognized stock exchange 0.017%

4 Sale of unit of an equity oriented fund to the Mutual Fund 0.25%

Source www.reliancemutual.com

Are there any risks involved in investing in Mutual Funds?

You may have seen the TV ads of Mutual Fund schemes that end with announcement in fast forward voice the disclaimer : “Mutual Fund investments are subject to market risks .. “ this is very true. Like any other non guaranteed financial instrument, there are various risks involved such as:

Price Risks : The prices of the underlying going down, leading to a lower NAV

Liquidity Risks : Markets being shut for a long period leading to the suspension of repurchase / redemption of investments

Default Risk : Bonds of a particular company defaulting on repayment affecting income/debt/hybrid funds

Credit Risk : Bonds of a particular company being downgraded by the rating agencies leading to lower prices

The best thing about all of this is that in real world, most if not all financial instruments carry these risks but do not inform the public about it. For example Bank Deposits are guaranteed only up to 1 lac rupees. Company FDs carry default risks. The only additional risk a MF holder has is the price risk which is true for any investment that has a market price(Real Estate, Shares, Gold, etc.,)

If there are risks with mutual funds, can only people with high risk tolerance invest in it?

Not at all, there are ways and means to mitigate the risks as follows:

The biggest risk is not investing at all, as inflation erodes the value of money and the future looks far from certain. Hence proper risk taking and planning are essential.

1. Have equity MF exposure within your tolerance
2. Ensure debt MF exposure are well spread out,
3. Have adequate exposure to debt assets outside of MFs such as FDs, Govt Bond such as PPF, POMIS, NSC, RBI Bonds etc.,

How do I go about choosing a mutual fund?

Once you determine your AAP, you can focus on what funds to invest based on certain criteria

Such as

1. Long Term performance record of the fund (whether the fund has delivered better return than its benchmark index)
2. Pedigree of the fund house (whether the AMC is a new entrant or from a reputed corporate with solid trust, expertise)

What is the difference between a mutual fund and portfolio management scheme?

The major difference is that the Portfolio Management Schemes are claimed to be exclusive and tailor made whereas Mutual Funds are ready made. Porfolio Management Schemes have high entry barriers such as minimum investment of 10 lacs or more whereas MFs take amounts as less as 1000 Rs. Since PMS are private the performance is not known in public domain. Overall an investor is better off with a Mutual Fund rather then a PMS unless his needs / the scheme are very unique.

What are the various ways to invest in mutual funds?

Mutual fund can be bought online, through an intermediary such as a broker, advisor or directly from the fund house.

What are the different types of Mutual funds?

Broadly the different types(and sub types) of Mfs are

1. **Equity Funds**
   a. Diversified (Meaning they invest across all industries)
   b. Sector /theme specific (invest in that particular sector or its allies such as infrastructure or energy or software etc)
   c. Dividend yield (stocks which pay high dividend)
   d. Index Funds (passively managed funds, which track a benchmark index like Nifty, Sensex etc)

2. **Debt Funds**
   a. Income Fund (Long Term bond that invest in bonds of corporates, government and other issuers)
   b. Short Term Income Fund (Short term bonds of issuers including corporates, government, banks)
   c. Floating Rate funds (invests in bonds whose interests are reset at preset time periods, like your floating rate housing loan interest, which are reset when interest rates go up or down)
   d. Liquid Funds (very short term bonds that mature within 180 days - an alternative to short term deposits)

3. **Hybrid Funds**
    a. Equity oriented – have an equity exposure of more then 65% rest in debt investments
    b. Debt oriented – have debt exposure of more then 65% and rest in equities
    c. Monthly income plans (have equity exposure ranging from 10- 25% and rest in bonds)

4. **Commodities funds** :Invest in commodities such as precious metals(gold etc), metals, energy, agricultural comm.., etc

5. **Real Estate Funds** :Not launched in India yet

What are the different plans that Mutual Funds offer?

The different plans available for the investors are

1. **Growth** – No distribution of profits (dividend) are given out, the only way an investor can realize profits is through capital gain by selling the units

2. **Dividend** – There are 2 sub types in this
    a. **Dividend Payout** – Dividend would be paid to the investor periodically depending on available surplus to distribute, either by direct credit or through a cheque.

    Eg : if a fund declared Rs 2 per unit (20% dividend) and the investor has 100 units he gets Rs 2 * 100 or Rs 200 as dividend.

    b. **Dividend Reinvestment**: Dividend amount declared is used to buy more units of the fund
    Eg: A fund declared Rs 2 Per unit and the NAV is Rs 12. If the investor has 100 original units and has opted for dividend reinvestment he will have 100 units original + Dividend of Rs 200 reinvested (ie Rs 200/12 = 16.67 units) . Total units after the dividend is reinvested would be 100 original + 16.67 Units reinvested = Total 116.67 Units.

Loads and expenses:

What is Entry/Exit Load?

Entry or front end load is a cost charged by funds to cover marketing and other expenses and is usually paid to the advisor or the broker

Eg: if you invest 100 rS and the entry load is 2.00% only Rs 98 is invested and units allotted for Rs 98.

Exit Load or back end load is charged to a fund when the investor exits or sells the funds

Eg: assume that you have units worth Rs 25000/- and the exit load is 1% then Rs 250 is deducted and you get Rs 24750/-

What is a contingent deferred sales charge (or CDSC)?

Sometimes the selling expenses of the fund are not charged to the fund directly but are recovered from the unit holders whenever they redeem their units. This load is called a CDSC and is inversely proportional to the period of unit holding, ie the longer you stay invested in the fund the lesser CDSC load will be.

What are management fees and expense ratios?

If I invest in mutual funds, how can I get my money out?

Its easy, By selling your units, as follows:

For an open ended fund you need to submit an letter for redemption before 3.00 PM on a working day. The redemption proceeds shall be sent by cheque within 10 working days from the date of redemption.

If the investor's bank has a tie up with the fund for direct credit, the sale proceeds shall be credited to his account at the end of the 4th working day from redemption date.

For a close ended fund you need to sell it in the stock exchange where it is listed, and receive the payment from your broker after 3 working days (sale date + 3 working days)

When you buy a mutual fund unit what exactly do you buy?

You buy units of the mutual fund entitling you to profits or loss on a proportional basis to your purchase. You get a statement confirming your personal details as well as the funds details.

What is NAV?

NAV is the asset value per unit of the fund. In simple terms it's the price at which the fund is available for purchase for that particular day. The formula used to calculate the same is as follows

$$\text{NAV} = \frac{\text{Market / Fair Value of scheme's investments + Receivables + Accrued income + Other Assets - Accrued expenses - Payables - Other Liabilities}}{\text{Numbers of Units oustanding}}$$

What is Sales/Purchase price?

Sale Price is NAV plus the front end / entry load added. For eg: if NAV is 10 Rs and entry load is 2.0% sale price is 10.20 Rs per unit.

What is redemption price?

Redemption price is NAV minus the back end / exit load added. For eg: if NAV is Rs 12 and exit load is 1% the redemption price is 12-0.12(1% of 12 Rs) = 11.88 Rs .

What is an SIP?

An SIP is an easy way to accumulate wealth over the long term. Money is invested monthly / quarterly in the mutual fund at a fixed date for a fixed number of months. So you can invest as little as Rs 500 or Rs 1000 for one year or more. This helps you accumulate capital, is less volatile as investments are spread over several months and is a great way to understand the markets.

Is investing using SIP a good idea? Why?

The biggest benefit is that you can start small. Another benefit Is rupee cost averaging, as SIP helps you lower the cost of purchases by automatically buying lower no of units when NAV is higher v(since amount per month is fixed) and higher no of units when NAV is lower.

What is an SWP?

SWP Is the opposite of SIP when the investment is made one time lump sum and a fixed amount is withdrawn at regular (monthly or quarterly) intervals.

NRI investing

Who is an NRI? Am I an NRI?

NRI is a person resident outside India who is a citizen of India or a Person of Indian Origin (PIO) or an Overseas Citizen of India.

An Indian citizen or a foreign citizen of Indian origin who stays abroad for employment/ business / vocation for 182 days or more or indicating an intention for an uncertain duration of stay abroad is a Non-Resident Indian (NRI).

Those who stay abroad on business visits, for medical treatment, or such other purposes, which do not indicate an intention to stay there for an indefinite period are not considered as NRIs. Students who has gone for higher education Overseas and Merchant Navy personnel are treated as NRIs.

Can NRIs invest in Indian mutual funds?

Yes, NRI can invest in Indian Mutual Funds

Who is not allowed to invest in Indian mutual funds?

Overseas Commercial Bodies (OCBs) are not allowed to invest in Indian Mutual Funds

How can an NRI invest in Indian mutual funds?

By filling up the application form online or with hardcopy and submitting the same at the respective funds or their R&T office. If the investment is with a rupee draft or bankers cheque, the rules are then as follows:

- A Foreign Inward Remittance Certificate (FIRC) or
- Confirmation letter issued by the bank confirming the source of funds and
- A photocopy of the Rupee draft/Bankers cheque

If the application is with a Rupee cheque of the NRIs NRE / NRO account, then the filled up form, cheque and photcopy of the cheque needs to be submitted.

Do NRIs require a Permanent Account Number (PAN) to invest in Indian mutual funds?

Yes, NRIs require a PAN to invest in Indian Mutual Funds

Are NRIs required to comply with Know Your Customer (KYC) process?

Yes, NRIs should comply with KYC process

Can NRIs invest in their resident country's currency?

No, NRI can invest only in Rupees and foreign exchange needs to be converted to INR before they can invest.

How will an NRI redeem funds?

By filling out the redemption slip or a letter for redemption, and forwarding the same to the R&T or by giving redemption requests online

Can the proceeds be repatriated back to their country's currency?

Yes, they can be repatriated back if the funds for the investment originated from a NRE account

Can NRIs enroll in SIPs?

Yes NRIs can enroll in SIPs

What are the tax rates applicable to NRIs? **

Dividend at the hands of NRI
Equity Schemes : Tax Free
Debt Schemes : Tax free

Dividend Distribution Tax (deducted by the fund and paid directly)

Equity Schemes : NIL

Debt Schemes: 12.5% + 10% Surcharge on the DDT and 3% cess totalling 14.163%
Liquid or money market schemes : 25% +10% Surcharge on the DDT + 3% cess totalling 28.325%

Capital Gains

Long Term

Equity Schemes : Nil
Debt Schemes : 11.33 %without indexation
22.66% with indexation
Short Term

Equity Schemes : 15% flat +10% Surcharge + 3% cess
Debt schemes : 30% flat + 10% Surcharge + 3% cess

Securities Transaction Tax : Deducted at 0.25% on equity funds at the time of either redemption or switch

Tax deduction at source for NRIS
Equity Short Term capital gains: 11.33%
Debt Short Term capital gains : 33.99%
Debt Long term capital gains : 22.66%

** Tax rates are subject to change

US investors

NRIs/PIOs can invest in all Indian mutual funds except in funds promoted by Asset Management Companies based in the U.S.