DEMYSTIFYING ALL THINGS FINANCE

FINANCE AND RELATED MATTERS ARE A VITAL PART OF EVERYDAY LIFE AND IT HELPS IF YOU GET YOUR FUNDAS RIGHT. BY BINDU GOPAL RAO

"I just cannot get my head around it. I don't know what mutual funds are or what the stock market is all about," said a friend to me quite recently. When I spoke to her, trying to help her decode her doubts, I realized quite quickly that this is a problem that is quite commonplace. Unless you have studied finance as a subject, it is likely that most terms appear as jargon. However, finance and related matters, whether loans, banking, insurance or mutual funds, are a vital part of everyday

life and it is imperative that you understand them right. So, here is a guide that will come in handy.

BANKS WILL CHECK YOUR CREDIT SCORE BEFORE GIVING YOU A LOAN. YOU CAN CHECK YOUR CREDIT LINE ONLINE TOO

LOANS

With limited money at your disposal, the only way to make larger investments especially in property is via a loan. And this is the time when loans are growing tremendously as a sector. In India both banks and Non-Banking Finance Companies (NBFCs) offer a range of loans. Of course most of us are familiar with housing or home loans that are taken to fund the purchase and/or construction and/or repairs and renovation of a house or a flat. Likewise there are education loans to fund further studies, car or auto loans to buy vehicles, commercial property loans to fund the purchase of immovable property for commercial purposes, personal loans that are unsecured and come with a high rate of interest as well as gold loans where you can get money for collateral of gold.

There is also loan against property where the collateral pledged is an immovable property and loan against security where the collateral pledged is a fixed deposit or a bond. The loan amount given is always based on your current earning level so make sure you take a loan which your income can help you service. Also there is a Credit Score, a three-digit number that is indicative of money-management skills and financial credibility and banks will check yours before giving you a loan. You can check yours online too.

Whatever the kind of loan you are taking, it is important to choose wisely. The first thing is to take an informed decision and choose the right institution from which you will be taking your loan. A key factor that will help you make this decision is the interest rate. This is the bank charges for lending you the money and is integrated into the EMI or equated monthly instalment that you pay the bank back monthly once the loan tenure starts.

When choosing a loan, read the fine print to check if the interest is charged as fixed or floating. Floating interest rates vary through the tenure of the loan as and when the Reserve Bank of India (RBI) changes the interest rates in tune with current market conditions. Fixed rate on the other hand is constant through the tenure of the loan. However several times there could be a caveat clause that allows the fixed rates to change which is something you should look out for. Processing fee is a fixed charge that the bank takes to process your loan application and can vary from 0.5% to 3% of the loan amount.

Do ensure you check on these charges before you take a loan. Some banks also charge for prepayment (when you choose to close the loan before its due date) as well as late payment charges that you must take care to avoid. In order to get the better of competition, banks also offer an option of auto transferring loans from one bank to the other. This is also called refinance loans and this can help you consolidate all your debt in one place. However, do remember that loans are to be taken only with full information and exercising the best caution – after all it is a debt that you need to repay.

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BANKING

The history on banking and banks in India dates back to several centuries and the RBI is the country's central banking authority that regulates, controls and inspects all banks including giving licences for new banks. All banks are broadly divided into scheduled banks and non-scheduled banks. All banks that are part of the second schedule to the Reserve Bank of India Act 1934 are called scheduled banks. There are 27 public sector banks, 26 private sector banks, 46 foreign banks, 56 regional rural banks, 1574 urban cooperative banks and 93,913 rural cooperative banks in India. A new banking model called Payment Bank has also been launched where banks can accept a specific deposit currently limited to Rs 1 lakh per customer but cannot issue loans and credit cards. Before you open a bank account check the terms and conditions attached including the annual fees for credit and debit cards that are not explicitly stated.

Coming to the aspect of the kind of accounts you can open, there are several choices with the most popular one remaining the savings account. Even within a standard savings account, there are variants that some banks offer and these include Max account where there is an auto transfer of funds into a fixed deposit that will earn you more interest as well. Likewise, there are women's savings bank accounts that allow special benefits like customized debit cards, exclusive shopping benefits, insurance benefits and preferential loan rates. Also check out the Kids Advantage accounts that give education insurance cover benefits as well. Senior citizen accounts that come with a slightly higher rate of interest are the best way to park their money. Current accounts are usually used by business folks as these allow for more flexibility as well as an overdraft facility (where you can withdraw money over and above your balance) if you are credit worthy. Foreign nationals can also open their bank accounts in India.

This apart you can go for a fixed deposit where you can set aside a lump sum amount that will earn you a fixed rate of interest. Most banks offer an additional 0.5% interest if the deposit is in the name of a senior citizen. Usually the rates are better for longer terms. If this does not work, you can also invest in a recurring deposit where a set stated amount is automatically debited from your account and moved to earn a higher rate of interest. Looking ahead, there is a clear thrust on improving banking infrastructure and technology. With the tremendous growth in mobile and internet banking services the need of the hour is to ensure these services become both reliable and robust. There are several banks that are also looking to launch contact-less credit and debit cards that use near field communication (NFC) allowing customers to transact without having to insert or swipe their cards.

MUTUAL FUNDS

As a form of investing your money, mutual funds are an option that is available especially when you are not aware of how to invest in stock markets. Simply explained, a mutual fund is a professionally-managed investment scheme offered by an asset management company whose expert fund managers invest money in stocks, money market instruments, bonds and other securities on behalf of the investors. Once you choose your predefined investment objectives and goals, the fund managers select broad portfolios including

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large cap, mid cap and small cap stocks to balance the risk and give you higher returns. As an investor, you can buy mutual fund units which are nothing but your share of holdings in the particular scheme. These units can be purchased or redeemed at the fund's current net asset value (NAV). Mutual funds are registered with the Securities and Exchange Board of India (SEBI) and function within the regulations created to protect investor interest. In fact you can start small and also do it in small steps. Going for SIP (Systematic Investment Plan) you can have your bank debit a set amount (as small as Rs. 500 also) to transfer into a predefined portfolio every month. SIP works on the principle of Rupee Cost Averaging, that keeps your money insulated against NAV fluctuations. You can also opt for Systematic Transfer Plan (STP) which is a plan where you can transfer your funds systematically from one portfolio to another based on your changing financial requirements.

> A SIP WORKS ON THE PRINCIPLE OF RUPEE COST AVERAGING, THAT HELPS KEEP YOUR MONEY INSULATED AGAINST NAV FLUCTUATIONS

There are several types of mutual funds and they are essentially classified on the types of securities where the funds are invested. Equity mutual funds are those that invest in stocks, debt mutual funds invest in fixed income securities like government bonds and treasury bills, hybrid income funds invest in a mix of equity and debt mutual funds and index funds track the performance of a specific index like the National Stock Exchange. Likewise, a closed-end fund is open for subscription only during the initial offer period and has a specified tenure and fixed maturity date when it can be redeemed. An open-ended fund is a scheme that is available for subscription and redemption on every business day through the year and is like a savings bank account.

An Equity Linked Savings Scheme (ELSS) is an equity oriented Mutual Fund that invests for tax saving and wealth creation with a lock-in period of three years. There are also speciality funds that invest in specific sectors, industries, regions or

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securities. Always remember to read the offer document which will explain aspects like management and expense ratio which gives you important data about the fund. For small investors, mutual funds are a great option as it gives them access to professionally-managed and diversified portfolios of equities and bonds.

INSURANCE

As an investment vehicle that offers tax saving, long-term retirement benefits and also cover for unforeseen situations, insurance wins hands down. Insurance is a contract between the insurer (the company that provides the insurance) and the insured (person who buys the insurance). The insured pays an amount at regular intervals called premium to the insurer who agrees to make good any financial loss that the insured may suffer during the tenure of the policy. The premium can be paid in fixed intervals, quarterly, half yearly or annually and there are some policies that have a one-time premium too. It is a great idea to cover your life through life insurance and health through health insurance. Other kinds of insurance include auto insurance for your vehicle, home insurance for your house, travel insurance and pension linked insurance schemes.

Do bear in mind that typically returns on insurance policies are relatively lower as they are intended to help you battle unknown events that can potentially disrupt your life. Currently there are 57 insurance companies in India with 33 non-life and 24 life insurers. The Life Insurance Corporation (LIC) is the only public sector government company and The Insurance Act, 1938 and Insurance Regulatory & Development Authority (IRDA) Act, 1999 are the primary legislations that govern the insurance business in India.

Since the premise is that it will protect you in the case of an unforeseen event that may or may not happen, companies are able to provide cover when required. The cardinal principle is to choose a policy based on your current and projected income, medical state, age and future financial needs as well as the cost-benefit ratio.

The insurance must cover all your dependants especially for health insurance policies. As a large number of people exposed to a similar risk participate in the scheme and contribute, it helps the insurer compensate the losses of some people who face these situations. Within the life insurance space, there are Endowment Assurance policies that also give a lump sum amount on the policy maturity in case the insured survives the policy term. Money Back policies on the other hand pay back set amounts at specific times through the course of the tenure. Unit-Linked Insurance Plans (ULIPs) are life insurance policies whose value varies based on the value of the underlying assets.

To protect customer interests, the insurance industry has ombudsmen in 12 cities who are empowered to redress customer grievances. With a plethora of options available in the market, choose your policy wisely and online comparison tools are a great way to check the short-listed options. It is important that you find out how the company has performed in terms of settling claims which is a key factor. Also look out for hidden charges as well as important features like continuance of life coverage post the completion of the policy term. ■

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