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Sources Of The Superannuation Income

A financially independent retired life is necessary for any individual. This in turn shifts the focus on an adequate provision of the superannuation income and the possible sources of this income

The old saying that 'there is always a means to an end' is true for almost all the aspects of human life. And if one looks at the financial aspects of any individual's life this saying would seem to form the very basis for everything. More aptly put, a financially successful life would require that 'there should always be a means to a desired end'.

The need for retirement planning for any individual usually comes in as the last of the financial milestones required to be achieved in his / her life. Nevertheless, successful retirement planning is very critical in ensuring a financially independent life in the post-retirement years. And hence, one should plan in advance his / her superannuation income needs and work towards the provision of this income during the working life itself.

In India, the social security system has had a strong presence in the traditional society in the form of the joint family system. At a time, when the concepts of pension, insurance and annuity were still evolving in the other parts of the world, the joint family system in our country very effectively looked after all members in a family including the elderly, widows and orphaned children. However, with the slow disintegration of this system and emergence of nuclear families, the need to particularly provide the necessary financial security to oneself and the loved ones has taken a front seat. This has particularly brought in the need for the provision of income in post-retirement years of ones life.

The range of social security schemes includes pension schemes, gratuity scheme, compulsory / optional health insurance, unemployment insurance, employer's liability for occupational accidents / diseases, civil servant schemes, family benefit and statutory obligations of employers. However, when it comes to the sources of the superannuation income, particularly those available in our country, one can think of three main sources, namely, the provisions by the government, the provisions by the employer and the self-financed provisions. We shall now have a look at each of these provisions.

Provision of superannuation income by the government

The world over, old age social security is provided by the governments in form of special retirement programs to financially help the retired and old people. In India too, the governments (at both the centre and the state levels) have well defined programs to provide financial security to the aged persons. The availability of these old age social security schemes is however limited to only a fraction of the population, primarily comprising of the government employees and the employees workers in the organized sectors of the economy.

In India, the government employees are covered by schemes such as family pension plan. The employees in the organized sector are

covered under the provident fund provisions, the superannuation fund provisions and the gratuity fund provisions. We shall look at the provisions by the employer's at a later stage.

The main superannuation benefits made available by the government are:

Pension

Old age benefits: Usually, a central government employee who is fully covered under the social security scheme will start receiving old-age benefits on attaining the age of 60 years (currently under consideration for revision). This benefit is also available in case of the state government employees, but with different retirement ages. The pension amount receivable after retirement depends on a number of factors, the most important of which is pre-retirement income levels.

Survivor Benefits: The pension benefit available to government employees is termed as the 'family pension' benefit under which the spouse of the deceased government employee will receive the pension, subject to the relevant provisions and the applicable rules. In other words, the spouse of the covered employee becomes eligible to receive survivor benefits if in case the covered employee dies, subject to compliance of certain statutory provisions.

Health insurance benefits

The employees covered under the pension plans provided by the government are usually also covered under ancillary health insurance plans. These plans assist in taking care of the expenses related to medicines, medical check-ups, and hospitalization expenses in case of an illness or surgery, etc.

Provisions of superannuation income by the employer

The various regulations and laws in our country pertaining to the human resource stipulate the provision of the superannuation income by the employers in the organized sector. These provisions are mainly in the form of provident fund and gratuity fund.

Provident Fund: The provident fund formation involves a combined contribution from the employer as well as the employee. 12% of the amount of the basic salary of the employee gets deducted from his / her gross salary and is to be submitted to the provident fund account of the employee. An equal amount is contributed by the employer and submitted to the above account. Both these contributions totaling to 24% of the basic salary of the employee are considered as part of the total remuneration package of the employee.

The main purpose of the provident fund is to create a fund that would form one of the main components of the wealth that can provide for an adequate income to the employee in the retirement years. This fund is all the more important in case of private sector employees to whom the regular pension benefits (as available to government employees) are not available. The amount in the provident fund account can be withdrawn by the employee before retirement, subject to the fulfillment of certain conditions as prescribed by Employee's Provident Fund Act.

Gratuity: Normally, the gratuity benefits get accrued to an employee's credit on his /her completing five years' of service with the employer. Gratuity can be seen as an expression of gratitude (although compulsory) by the employer to the employee for having worked for the former for a good period of time. The benefit amount gets calculated at the rate of 15 days wages / salary for every completed year of service. For computation purposes, the monthly salary is taken as that for 26 days.

The above condition of 5 years is not applicable in case of death or permanent disablement of the employee. Gratuity is payable at the time of retirement, resignation / termination, or death / permanent disablement due to an accident / disease. Traditionally, however, gratuity has been acknowledged as an important component of the retirement benefits of any employee and thus forms a significant part for the provisioning of the employee's income in the retirement years.

The above two provisions have been looked upon as the pillars of

financial support to an employee in the retired life. These benefits, even if adequate, would still have some limitations. The fact still remains that these benefits are usually available only for salaried and permanent employees and not for temporary or contract employees. Further, employee turnover causes hindrance in the continuation of these benefits. Also, the cost consciousness on the part of the employer may result in a shift of these benefits from being employer-subsidized to employee contributed.

Self financed provisions of superannuation income

As discussed earlier, only a small percentage of the population in India is covered by the social security provisions associated with old age. The remaining majority of population has to look at self-provisioning of the necessary means of income in the retirement years. Moreover, with the large number of people looking at professions and self-employment avenues for earning livelihood, this self-provisioning becomes all the more important.

We will bifurcate our discussion on the self-financed provisions of superannuation income into the sources for creation and growth of wealth and the means of payout of this wealth as the superannuation income. The payout part will also be applicable in case of the provisions of the superannuation income by the employer.

Some of the investment avenues available in India, also seen as popular means of creation and growth of wealth are gold, real estate, direct equities, equity linked investment avenues, debt investment avenues.

Gold: Since ancient times gold has been a valuable commodity. From being the basis for making of jewellery to that of the valuation of various currencies in different eras, gold has always been the object of desire for all. The limited gold reserves of the world and its demand always exceeding its supply ensure that investments in gold deliver / surpass the expected appreciation.

Real Estate: The ever existing needs for shelter, always keeps up the demand for land and construction activities. This in turn

makes real estate an attractive investment avenue, capable of growing the money invested in it to a very great extent. Investments in constructed properties such as independent houses, apartments, buildings, flats, etc. are subject to depreciation with time. However, investment in land is not subject to any depreciation and usually grows at a pace faster than the growth of investments in constructed properties.

Direct Equities: The ownership in a company brings with it the right to share the profits accruing on account of the good performance of the company for a particular period as well as intense trading of the shares of the company on the stock exchanges. Long term investments in fundamentally strong companies thus assist in wealth creation and growth.

Equity Linked Investment Avenues: Avenues such as mutual funds, unit linked insurance plans invest in direct equities. Thus they pass-on the benefits of the growth potential of direct equities to their investment along with the added advantages such as professional management of investments, insurance cover (in case of ULIPs) and reduction in investment expenses (due to economies of scale achieved by investing on a large scale).

Debt Investments: Debt instruments such as national savings certificates, bonds, government securities, bank deposits, etc. provide the means of the capital appreciation on a conservative basis.

Once the required wealth has been created through the above investment avenues, the same will need to be channelized towards an avenue that enables the systematic liquidation of this wealth to provide the recurring income flow in the retirement years of life. Such a popular avenue is the annuity plan made available by the life insurance companies in our country.

The word 'annuity' means regular periodic payments. The annuity plans involve the payment of an amount (either lump sum or in installments) known as the Consideration Amount by the purchaser of the plan who is known as the Annuitant. This consideration amount forms the basis for the provision of a regular flow of

income to the annuitant by the seller of the plan (usually an insurance company).

Annuity plans can be classified on a number of factors such as:

1. Time of commencement of the benefit payments.
2. Continuity of benefit payments.
3. Number of annuitants

Depending on the time when the annuity payment begins, there are two types of annuity plans. These are (a) Immediate Annuity Plan (b) Deferred Annuity Plan.

Immediate Annuity Plan: Under an immediate annuity plan, the first benefit payment becomes due just one payment interval from the date of purchase of the annuity plan. If the benefit payments have been chosen as to be received every month, the first payment will be due one month from the date of payment of the purchase price. For example, if the annuity plan has been bought in May 2008, the monthly benefit payments will start from June 2008. Similarly, the quarterly, half-yearly or yearly benefit payments will commence from August 2008, November 2008 or May 2009 respectively for an immediate annuity plan bought in May 2008. The immediate annuity plan is always purchased with as a single premium plan.

Deferred Annuity Plan: A deferred annuity plan can be purchased as either a single premium plan or installment premium plan. Under this plan, the benefit payment begins after a certain time interval (usually a few years) from the purchase of the annuity plan. The period from the start of the premium payment and till the commencement of the benefit payment is known as the deferment period. An example will further clarify this plan. A deferred annuity plan is bought in May 2008 with either a single premium of Rs.12,00,000 or through 12 premium installments of Rs.1,00,000 each payable monthly. The deferment period for the plan is 5 years. Hence, the benefit payments (taken as monthly benefit payments) will commence from May 2013. The advantage that this plan offers is the expertise of the annuity

plan provider (usually an insurance company) in managing the investment amount over the deferment period.

Depending on the continuity of the benefit payments, there are mainly three of annuity plans. These are: (a) Annuity Plan for Life; (b) Annuity Certain Plan; (c) Annuity Certain Plan and then for Life.

Annuity Plan for Life: Under an annuity plan for life, the annuity benefit payments will be made to the annuitant for the entire remaining life, i.e. only up to the time he / she is alive. On the death of the annuitant the benefit payments will be stopped, irrespective of the time that has passed by since the commencement of the benefit payments. This plan will hence be of disadvantage to people who had purchased an annuity plan, adequate enough to provide them with benefit payments for a long retired life, but who passed away soon after the commencement of the benefit payments.

Annuity Certain Plan: Under an annuity certain plan, the benefit payments are fixed for a certain time period or for a certain number of benefit installments. In case of death of the annuitant before the completion of the pre-decided number of benefit payments, the remaining benefit payments will be made to the nominee of the annuitant. However, with the annuitant surviving at the end of the benefit payment term or installments, the superannuation income will cease and so will the financial security for the annuitant.

Annuity Certain Plan & Then For Life: This annuity plan came as a solution to the disadvantages of both the annuity for life and annuity certain plans. Under this annuity plan, the benefit payments will be guaranteed for a certain period of time or certain installments. If the annuitant is surviving beyond this time, the benefit payments will continue to be paid up to the time the annuitant is alive.

Depending on the number of annuitants, there can be two annuity plans. These are: (a) Single Life Annuity Plan; (b) Joint Life Annuity Plan.

Single Life Annuity Plan: The benefit payments in a single life annuity plan are designed taking into consideration the superannuation income needs of only one person i.e. the annuitant.

Joint Life Annuity Plan: Under the joint life annuity plans, the benefits are designed keeping in view more than one life. Usually these plans are available for married couples. Here, the annuity benefits are paid in full as long as both the 'husband and wife' are alive. On death of one of the joint lives, the benefit

payment continues but usually at a reduced rate (say 60% of the original benefit amount) for the surviving spouse. On death of the second life, the benefit payment stops.

The above classifications are defined more for understanding purpose and in reality the insurance companies provide annuity plans that are a combination of two or more of the above discussed plans. As an example, a joint life annuity plan could have the option for choice between annuity for life or annuity certain & then for life. Also, this plan would either be an immediate annuity plan or a deferred annuity plan.

Product Showcase :: Pension Plus

Pension Plus is a unit linked pension policy from Aviva Life Insurance Company India Limited. This is non-participating policy.

Unique features

Increase of regular premium – Policy provides the option to increase regular premium by 2 methods:

- 1. Through indexation** – increase of the regular premiums by an indexation rate at any policy anniversary. Here, the purpose is to protect the real value of investments against inflation, as the indexation rate will be in line with the increase in the Whole Sale Price Index. Once opted for this will become a default option unless altered.
- 2. Through Additional Regular Premiums (ARPs)** – increase of the regular premiums on every policy anniversary through ARP. Minimum ARP is Rs.1,000 and there is no limit on the maximum ARP. The regular premium once increased cannot be reduced in future.

Loyalty additions – Policy provides for loyalty addition for all policies with policy term of 20 years or more. The loyalty addition is a percentage of the fund units value pertaining to regular premium only and ranges between 1% and 2%, depending on the policy term. This addition is payable at policy maturity and is not available in case of a single premium policy.

Change of policy term – Policy term can be reduced to postpone the maturity date, provided policy has completed at 5 years and age of policy holder on the revision date is at least 40 years. Maturity date can also be post-poned with or without the premium payment for the extended term, subject to policy conditions.

Top up premiums – can be made as lump sum investments in the policy to enhance the policy funds. Minimum top-up premium is Rs.1,000 and there is no limit on the maximum amount of top-up premium. The top-up premiums will be invested in various investment funds in the same proportion as selected for the regular premium allocations.

Policy benefits

Vesting benefit – At the age of vesting, one-third of the fund value can be commuted as tax free lump sum amount. The remaining amount can be used to purchase an annuity plan from either the above insurer or any other life insurance company.

Death benefit – In the unfortunate event of death of the policy holder during the policy term, the nominee will receive the fund value pertaining to the regular (or single) premiums higher and top-up premiums, if any.

Eligibility parameters

Age at entry – minimum – 18 years; maximum – 65 years

Vesting age – minimum – 40 years; maximum – 70 years

Policy term – minimum – 5 years; maximum – as upto the chosen vesting age

Policy can be taken as a single premium policy or a regular premium policy

Premium payment frequency (in case of regular premium) – Annual, semi-annual, quarterly and monthly. Monthly premium frequencies are available only under ECS.

Minimum premium amount – Rs.6,000 p.a. (Rs.15,000 p.a. for policy term less than 10 years); Rs.1,00,000 for single premium policy.

Premium can be paid by cash (at any of the offices of the insurance company), cheque / demand draft payable to the company or through direct debit or electronic clearing service.

Choice of investment funds

Policy provides the choice of 4 investment funds. Policy holder can choose from one or more of these funds based on the unique investment requirement and risk-return profile. The details of the funds are:

Fund Name	Investment Objective	Risk Profile	Investment Allocation in		
			Debt securities	Money market securities	Equities
Pension Index Fund	To generate returns in line with stock market index – Nifty	High	0% to 20%		80% to 100%
Pension Growth Fund	To generate long term capital appreciation with high equity exposure	High	20% to 60%	0% to 40%	20% to 60%
Pension Balanced Fund	To generate balance of capital growth and steady returns	Medium	50% to 90%	0% to 40%	0% to 45%
Pension Protector Fund	To generate steady returns with minimum exposure to equities	Low	60% to 100%	0% to 40%	0% to 20%

Policy provides for the option to change the allocation of the various investment funds to cater to the changing financial priorities and objectives. This option is available 2 times in a policy year and is subject to the condition that minimum allocation in each selected fund should be at least 10%.

Policy also provides for a provision for switching of the investment value from one fund to the other. Here, the minimum amount switched and the minimum balance in a fund after the switch should be Rs.5,000. Policy provides for 4 switches, free-of-charge in a year. Every additional switch will attract a charge of 0.50% of amount switched subject to maximum of Rs.500 per switch.

Policy charges

Premium allocation charges – ranges between 7.50% to 25% in the 1st year, depending on the annual premium amount; 2nd year onwards it is 2%. For single premium policies, it is 2% for premium amount below Rs.5,00,000 and 1% for a premium amount of Rs.5,00,000 and above. For top-up premiums, premium allocation charge is 2%.

Policy administration charge – is Rs.51 p.m. to be increased at the rate of 5% p.a. on 1st of January every year. For single premium policy it is Rs.30.

Fund management charge – ranges between 0.75% and 1.50% p.a. depending on the choice of the investment fund.

Policy surrender

Policy can be surrendered after the completion of the first 3 policy years and provided premium for more than one year has been paid. The surrender value is subject to deduction of a charge. However, if more than 4 years of premium has been paid, no surrender charges will be applicable.

Tax benefits

Premium paid under the policy is eligible for deduction as per the provisions of Section 80C (which includes Section 80CCC for pension plans) of the Income Tax Act, 1961. The policy benefits are exempt from tax under the provisions of Section 10(10D) of the Act.

Important: In this policy, the investment risk in the investment portfolio is borne by the policy holder.

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