Learn the basics of savings and investing

Earning Curve

Passing on Your Financial Legacy

Have we thought what will happen to our investments after we're gone?

Many of our readers have a sound knowledge base for investing in various financial instruments. By keeping track of the latest developments, and doing some analysis of your own, you may have built a decent portfolio that yields good returns. But have you stopped to consider what will happen to your investments after you are gone?

The reason you are slogging hard to earn a decent income and investing it is to provide for your family—your children, spouse, parents, and so on. So, have you made sure that your investments will pass on to your loved ones in the manner you desire? The way to do this is through a nomination.

Nomination is one way to pass on your assets to someone else. If you have provided the name of a nominee for an asset, it would be passed on to that person after your death. But hold on; it's not as simple as it sounds. There are countless legal aspects to transmission of assets that can skew the picture irreversibly if you are not careful.

As per the law, a nominee is only a trustee and not the legal owner of the assets. He is only supposed to hold the assets in trust till they are passed on to the legal heirs. Even then, the law has different connotations for different financial instruments. The nomination facility is available for most financial assets like shares, mutual funds, bank accounts, PPF accounts, demat accounts, etc. Let us consider the legal implication of nomination for shares.

In most cases, legal heirs can lay a claim to the financial asset, even if someone else has been named as nominee. However, this does not apply to shares. A recent judgement of the Bombay High Court has overturned the established practice in the matter of transmission of shares by giving all ownership rights to the nominee rather than to the legal heirs. This means that if the nomination is valid, the nominee is entitled to ownership rights of the shares, to the exclusion of the legal heir.

Everyone would want to ensure proper legacy for their loved ones. The way to do this is through a comprehensive will and by completing nominations and transmission formalities. Getting these aspects right is crucial if disputes between heirs over legacy are to be avoided. Moneylife Foundation recently held a series of workshops on nomination, transmission of shares and mutual funds and other assets. Watch this space for more on how to pass on your assets.

Build Retirement Kitty through NPS

NPS can turn our retirement savings into a sizeable kitty

If you are serious about building a substantial corpus by the time you retire, long-term savings schemes will pave the way for you. Within these, the New Pension System (NPS) is a product that could actually turn your retirement savings into a sizeable kitty. While the mechanics of this scheme are still undergoing changes, the fact remains that it is the best long-term savings option in the market for those who don't want to know anything about stocks, mutual funds and asset allocation.

Under the revised draft of the Direct Taxes Code, the NPS is proposed to be brought under the EEE (exempt-exempt-exempt) method of taxation. This means that investors get a tax exemption at all three stages of investment, appreciation and withdrawal. The government has also announced a bonanza for investors by committing to contribute Rs1,000 to every new NPS account every year for the next three years. The scheme, called 'Swavalamban', will be extended to those who join NPS with a minimum contribution of Rs1,000 and a maximum contribution of Rs12,000 a year in the current financial year 2010-11.

The NPS is a defined contribution pension scheme, open to Indian citizens between 18 and 55 years of age. Subscribers are required to invest a minimum of Rs6,000 each year until they retire. At retirement (age 60 years), investors would be required to invest a minimum of 40% of the accumulated wealth to purchase a life annuity. The rest of the money can be withdrawn in a lumpsum on reaching the age of 60.

Under NPS, subscribers can choose from a list of seven pension fund managers (PFMs) to whom they can entrust their savings. They are, ICICI Prudential Pension Funds, IDFC Pension Fund, Kotak Mahindra Pension Fund, Reliance Capital Pension Fund, SBI Pension Funds, UTI Retirement Solutions and LIC Pension Fund. So far, all PFMs have delivered similar returns and, hence, it is too early to say which ones are worth considering.

NPS offers two investment choices—auto choice and active choice. Under auto choice, your funds are invested as per pre-defined asset allocations that change over the lifecycle of the subscriber. Under the active choice, investors can decide what asset allocation to go with (subject to a maximum of 50% in equities).

The Tier-I account in the NPS does not offer the facility of withdrawal before the retirement age. However, the Tier-II account allows withdrawal. Only, you need an active Tier-I account to open a Tier-II account. What makes the NPS such a unique product is the low charges and the potential to deliver solid returns, due to the equity component. In a country with limited post-retirement benefits, the NPS makes for a very welcome option. ■

Stock Shastra #3

Parameters to Shortlist a Wonderful Stock

An excellent financial track record is the most critical criterion for finding a wonderful business worth investing in. However, understanding the company financials is not an easy task. A big, fat, 100-page annual report with reams of data leaves most of us confused! It seems too difficult and too complex and needs too much time.

However, there is a simple and powerful lens which can help you identify such companies. From all the 100+ parameters, all you need are just five key parameters. Seen together and over 10 years, these five reveal whether the company has performed well in the past. Here are the parameters.

EPS: For a business to be worthwhile, it should make profits, consistently. As a shareholder you need to look at the profit it earns per share, that is, EPS.

Net sales: A company can continue to earn profits consistently only by selling more and more of its products. Increasing net sales indicates increasing demand for the company's products.

BVPS: To increase its sales in the long run, a company will need to

expand its capacity. The book value per share (BVPS) tells us how much a company is investing in expanding its capacity.

ROIC: Companies are basically money-using and money-making machines. They make money (profits) by using the money invested (both equity and debt). Hence, to know the efficiency with which a company uses money, i.e., its capital, look at return on invested capital (ROIC).

Debt-to-net-profit ratio: Finally, if a company borrows money, it should be able to repay it, without serious difficulty, over a reasonable period of time. This ratio tells you the number of years in which the company will be able to repay its debt.

A company that has been growing its EPS, net sales and BVPS by 12%+ year-on-year has ROIC of over 12% every year, and can pay off its debt in less than three years, that is, a debt-to-net-profit ratio of 3 or less, is said to have a great financial track record. Scrips of companies meeting this gold standard are wonderful investments, worth short listing.

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