HOW TO BE YOUR OWN FINANCIAL PLANNER IN 10 STEPS

Acknowledgement

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Manish Chauhan

CONTENTS

Step 1

Optimize Life Insurance Policies

The first step in your financial life is to clean up your life insurance portfolio, before we start work on different areas of your financial life. We will try to optimize the mess created in your financial life due to life insurance policies and make sure you are adequately covered.

How many life insurance policies do you hold? 1, 2, 3 or more? Now, check what kind of life insurance policies you have.

Check any person's "Life Insurance Portfolio" and there is a very high chance that he will have a few traditional life insurance policies. It's exceedingly rare for him to not have one. In fact, you too probably have at least one in your financial life. Either you bought it for tax saving purposes, or your parents bought it for you and now you are carrying the legacy and paying the premium after you started earning.

There is another possibility. You didn't wanted to buy these policies, but your parents, uncle, aunty, or neighbourhood uncle/aunty made the decision for you and convinced you about its usefulness in your life and that it's a "must have" product because they trust either the concept or the company that sells the product. They make it sound like the "way to go" concept!

It happens!

It has happened with millions of people in India and it happens every day. It has happened yesterday and it will happen tomorrow again. The problem is not that you had to buy these life insurance policies and this incident happened in your life, but the real issue is - "what you are doing right now" with it? What is its role in your financial life, what does it contribute towards your wealth generation or does it even do its core job of "Protecting your family security" or "Life Insurance"? Is it adding value to your financial life? Or is it slowly destroying your financial life and your wealth creation process without your knowledge!

Let's openly talk about it now, "it" being traditional life insurance policies. The policies that combine life insurance and investments into one bundled product. Admit it. You know you bought those traditional life insurance plans for **investment purposes.** Don't fool others by saying "No no! It was only because I wanted my family security and nothing else". That's kind of a lie, otherwise you would have taken a Rs. 50 lacs term insurance policy, not a Rs. 5 lacs sum assured policy with life insurance as the cherry on top, exactly the same way you have a chocolate layer on a chocobar!

Now what to do?

We will divide this chapter into 3 parts and take them one by one. Each part has its defined purpose and will help you progress and correct your life insurance portfolio.

What I have seen in my last 5-6 years of experience in personal finance is that most people are happy with a simple explanation that leads to good results, rather than a complex explanation leading to excellent results. Truly speaking there are no excellent results, it is a myth. The whole world of personal finance is very simple, but those who work in that area try to showcase it as a complex domain at times, which scares the common man. It makes an investor feel that without external help, he can't do much. But in this book, we will try to break that myth. There is very little to do in the area of Life Insurance, but what is required is a strong understanding of the fundamental concept. With some basic guidance, you would be able to do things on your own, nothing fancy. Just get your basics in place and understand the core concepts of life insurance and how low returns can hamper your financial life in the long term. Let’s start.

1. Background

Let me start with some education by introducing a few terms and rules about traditional life insurance policies. Most people who hold traditional life insurance policies don't even understand the terms associated with it and how it works. This is one reason why they harbour wrong beliefs. Pick up your traditional policy right now and check its brochure documents and you can see all these terms.

a) Surrender Value - Surrender Value is what a life insurance policy is worth at a given point of time. You will get this value when you want to stop your policy. In almost all traditional life insurance policies, there is no surrender value before 3 years. This means that if you want to close the policy before paying 3 years of premium, you get nothing, absolutely nothing: it's a complete loss for you. And after the 4th year, the surrender value of the policy is very small compared to your premium paid. It's a % of your total premiums paid until now (excluding the first-year premium). It starts with 30%, and keeps increasing as the tenure increases.

This means that if a policy has 20 years tenure and you want to surrender it in the 4th or 5th year, the surrender value would be close to 30-40% of your total premiums paid excluding the first year premium. If you want to surrender it in the 10th year, the surrender value would be much more than 30%, it might be close to 60-80% of your premiums paid. The good part of surrendering it later after a few years is that you also get the bonus part of your policy, if applicable, which is reduced to match the current worth.

If you want to know what your policy surrender value is, just call your company's customer care and enquire about the surrender value of the policy if you want to get back the money today and then compare it with your "premiums paid" until date. See how less it is! It's important to understand this fact that the earlier you surrender a traditional plan, the lower the surrender value is. In an emergency if you want to get back your money from these policies, you will be unhappy with what you get.

When you try to surrender your policy, you will face resistance from the agent or the company. Be firm about your decision.

Caution - When you go to surrender your policy, you will face strong resistance from the agent or the company itself. They will try to tell you why it's a bad decision and do whatever they can to reverse your decision. Don't buy into their arguments and be very clear why you want out. If you do not get any support from anyone, stay very firm about your decision. You can always go to the company office and surrender the policy. There is a surrender form, fill it and complete the process.

b) Paid up Policy - If you do not want to surrender your policy and take the money right now, the next best option is to make a policy paid up, which means you do not want to pay premiums further. In this case you will get your premiums paid + bonus accrued at the end of the policy maturity. One very common situation is when the premium is very high and most people cannot afford to pay the premium due to other commitments like home loan EMI or more expenses. At that time, they make the policy paid up. This way they save the money going out of their pocket and get the money at maturity. However, in this case your life insurance will stop, which might be ok, because in most cases, the sum assured is so low.

Example - If you have a Rs. 5 lacs sum assured policy, and you paid 5 premiums of Rs. 30,000 per year (or total Rs.1.5 lacs), you can now make the policy as paid up. In this case, you will not have to make any more premium payments and you will get Rs. 1.5 lacs at the end of maturity period. However, if you want to surrender the policy now, you will get close to 30-40% of your 4 premiums (first premium is not included in Most policies), so that would be just Rs. 40,000 - 50,000 despite paying Rs. 1.5 lacs.

c) Bonus - Yearly Bonus: Many traditional policies announce a yearly bonus at the end of each year, which keeps on accumulating and is given to you at the end of maturity period. So if a policy declares a bonus of Rs. 44 for every Rs. 1,000 of sum assured, and your sum assured is Rs. 10 lacs, your bonus for one year will be Rs. 44,000 (4.4%), but this is the amount you would get at the end. So, if there was a 20 years policy, it declared a bonus of Rs. 44 for every Rs. 1000 of sum assured, and you would get Rs. 44,000 of bonus each year, the total would be Rs. 8,80,000 for the whole policy term, and will be paid along with sum assured at the end. Don't forget that this bonus is mostly the amount you are going to get at the end; hence, it's a future value. This means that if you surrender a policy before the maturity period, you would get a reduced bonus amount today (current value of that future money).

Final Bonus or Loyalty Bonus: Few policies also give an extra bonus at the end of the maturity, called loyalty bonus, provided you have paid for all the years. It's a reward for being loyal and keeping your promise to pay for all the years. This amount can be a very small or big depending on the policy. You will have to check your policy for details.

So what do you get at the end of the policy maturity?

The key takeaway here is that at the end of the policy maturity, you will get your sum assured + bonus (which is not promised at times and gets declared each year, but almost all policies have a bonus component because companies keep on making profits year after year).

So you will now realise that with traditional life insurance plans, most times, you cannot be 100% sure of the maturity amount you will get, because it depends on the bonus amount; however, you can make a close enough estimate of the maturity amount based on some assumptions about bonus. So make sure that when you buy a policy you do not believe what the person selling you the policy tells you about getting a fixed number as the maturity benefit. There are cases where an agent promises a big lump sum when selling the policies and when the investor later discovers that it was just an estimate based on some numbers, they feel bad. I hope your case was not the same. Check your policy document right now for the indicative maturity value of your policies.

Real Life Experience

A woman, Radha, shared a story on my blog www.jagoinvestor.com, where she talked about how her mother was paying the premium for a LIC policy assuming that she would get a good amount on maturity. But she was shocked to find out that there was no maturity value in that policy. The policy was just going to pay a lump sum amount + pension to the disabled person who is dependent on the policyholder in case of death.

My mother was sold the LIC Jeevan Adhar Policy (for disabled people, as my sister suffered from mental retardation) by an agent some 15 years back and she was told that very good bonus will be added to her money and will be paid at maturity. Now it is going to mature next year and when she wanted to know how much will she get, she found out that it's a policy like a term policy, money is paid to the beneficiary after the death of the insured. She works in a government job and had already planned well for her insurance, was this policy mis-sold to her or is she misguided still.

You can see from this incident that the woman wrongly assumed that she would get a big amount from the policy and believed what she was told. But she never checked about the policy wordings herself and kept on paying in the misguided belief that it would pay her back in the end. It might happen that you are also not very clear on what you are going to get out of your policy. I suggest that you find out exactly what you will get. Although we love surprises in general, you will not appreciate this particular surprise!

I hope this background is good enough to proceed. There are different kinds of policies with different rules, but the above-mentioned rules and terms are generally applicable for all kind of traditional life insurance plans.

Safe but low return products

Note that these policies are secured products that have your money safe, but at the cost of low returns. The return you get from these policies hardly cross inflation figures, so you can't get excellent returns from these policies. It's more of a saving instrument rather than a capital growth instrument. Before I move forward, I want you to do a very small task, a small one, but one that will help you ahead. Just write down two things and ask yourself:

1. How many life insurance policies do I have (in numbers)? ___________________

2. What is the premium I am paying for per lac of coverage for each policy?

Policy Name	Premium / Year	Life Insurance Coverage	Premium / Per lac of Life Insurance / Year
Example Policy	30,000	6,00,000	5,000
Total			

Premium Per lac of coverage per year = Yearly Premium * 1,00,000 / Life Insurance Cover

There is a good chance, that you thought **"Ah! Let's move ahead, I just have to understand that concept, I will do it at the end."** This attitude has contributed in destroying your financial life and it's probably why you are reading this chapter. My suggestion is to actually take a pencil to paper and do it. After all, it will not take more than 10 minutes of your life.

Now let's talk about these two points.

Point 1: How many life insurance policies do I have?

What matters for you when it comes to life insurance? “Having many policies” or “Having sufficient life cover”?

Before answering this, just try to understand that when you die, your family will get a sum assured from these policies and if you don't die, you might get some return from these policies if you bought them from an investment point of view. If your total sum assured were Rs. 20 lacs, your family would get only Rs. 20 lacs, irrespective of whether you have 2 policies or 10 policies.

Most people have many policies and very small coverage from those policies. There are mainly two disadvantages of this strategy:

Disadvantage 1 - You have to manage so many policies, keep those documents, ensure that they are safe and store them. This adds to your work and increases the risk of mismanaging.

Disadvantage 2 - The bigger disadvantage of having too many policies comes up when you are not in this world, and your family has to claim your life insurance money from all the policies. This is a very under-looked factor because it slips your mind, as you don't have to deal with it today.

1-2 life insurance policies will do the same thing what 10-20 policies will do once you die. So focus on life cover amount, not the number of policies

If you have 10 policies, then your family will have to file claims for each of them, fill 10 forms, and run around offices for all those 10 policies. Whether they get the claim or not is immaterial, what is important is the amount of frustration and confusion they will undergo. This is also a metaphor for the amount of confusion and headache you are carrying in your life insurance portfolio.

I believe these two points are enough to convince you to get rid of some policies and bring down their number to ideally 1 or 2. Not more than that, and we are purely talking from a life insurance point of view, not an investment point of view.

So if you have 10 policies with coverage of Rs. 2 lacs each, it’s the same as having coverage of Rs. 20 lacs from one policy, or coverage of Rs. 10 lacs from 2 policies. Everything remains same for you, and your headache of managing them, along with your family’s headache eventually, comes down drastically.

2. Cleaning your life insurance portfolio

Let's see how you can clean your insurance portfolio and get rid of some of the policies that do not serve your financial life. To do this, ask yourself this. Why did you buy an insurance policy at all? The honest answer in most cases would be:

The coverage in case of a Team insurance plan is around Rs 100 per year for every Rs 1 lac for a young person

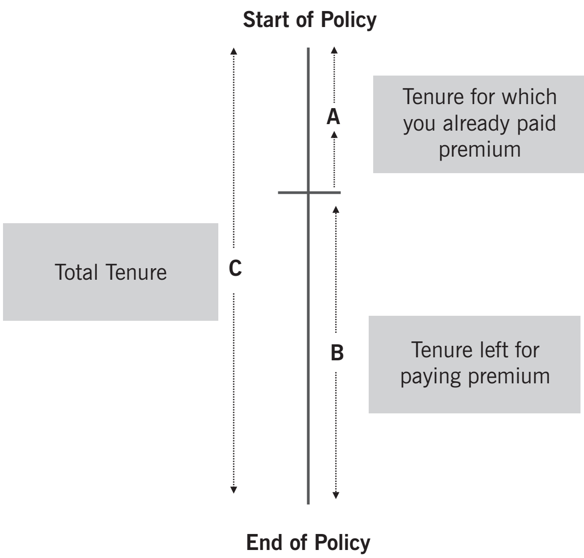
Reason 1 - From an investment point of view (mainly for saving tax)

Reason 2 - To also have some life cover

But the sad part is that your existing policies neither give you decent life insurance cover, nor do they provide you the kind of return you desire. Let me prove it to you. Visualise a scenario where your family gets the sum assured from your existing life insurance policy; on an average, it's generally Rs. 5-10 lacs. In this fast-paced world with so many necessities, it would not last for even 1-2 years. So it falls short of your need from a life insurance point of view. If you look at it from a return point of view, just imagine 10, 15 or 20 years from now when you actually get money from these policies, will that money be enough for your needs, both in terms of value and worth? How much will it help you, considering that you will continue to lead an expensive life even into the future? So even from a "capital growth" point of view, these policies are not serving you. You are the best judge if you need these policies. I would recommend that you get rid of those kinds of policies that do not meet both these criteria. Identify which policies are low on cover where you are paying very high premium for coverage.

But you will ask - "Is stopping a policy a good decision assuming I have already paid some years of premium? Won't I incur a loss?"

That's a very emotional way of looking at it. The human mind stops you from taking an action that contradicts your original plan. This question simply means that by not doing anything, you are just trying to repair the situation and are emotionally attached to what you've already paid. The money spent stares at you asking you, "So, did you pay so much money for waste?" and you cannot think logically at this point of time. What really really really matters is the current situation and what lies ahead. For a logical view of matters, see the image below.



If you look at the image, you will see that there are 3 kinds of tenures.

A	The phase or number of years, where you have already paid the premiums.
B	The phase where you still need to pay the money, this phase can be either in the same policy, or some other investment product.
C	The total tenure.

Ideally, when most people are thinking over the decision of what to do with an existing policy over-focus on A, which has already happened. But what really matters is phase B, which is real and current, and which is in your control. What you do in phase B really will decide if you managed or mismanaged things.

You can always invest your money for the remaining period in some other financial product. So, what matters is the total of Part A and Part B; even if Part A gives some loss, if you can manage to generate decent returns in Part B, it is enough to negate the loss from part A, and eventually exceed the default situation (when a person continued with the policy and completed C).

So logically - Situation A (not in your control) + Situation B (in your control) should be better than Situation C (your default situation).

Let me give you an example.

The slow infection

There was a man who led a very healthy life for years. Suddenly one day he learned during a health check-up that he had a strange kind of infection originating in his index finger. This bad news affected him deeply. He was told that the infection had started increasing and spreading to other parts of the body. It would slowly spread to the other fingers, then to the hand, and then the entire body.

The only choice to stop it from further spreading was to cut the finger itself so that the infection stopped spreading. But it was a tough decision, and he could not imagine bearing the pain of a cut finger. The fact that the big damage would show months and weeks from now meant that the guy never seriously cared about the infection deep down. But as time passed and the infection spread to his hand, he regretted not cutting off the finger and letting the infection spread to the whole hand. Even then, he did not amputate his hand, and finally the infection spread to the body, he was left paralysed for life and one day he died.

Learning

In our life, we take some bad decisions at times, which can leave an effect like the infection in the story. It can be a bad relationship, working in a bad job or company or having made some wrong investment decision. Taking a corrective measure is not that easy because the damage does not seem to be big instantly; the short-term pleasure of not doing anything is so great that people just mess up things more for longer. Whether to stop your bad policies and take corrective measures or not is same kind of decision that the man in the earlier story faced about cutting his finger or not.

Yes, the pain will be huge, but it will save your hands and whole body. Don't let it spread. Cut it now! Let me give you an example:

Example

Ajay bought a Rs. 10 lacs policy for 25 years tenure, the yearly premium is Rs. 40,000 and the death benefit is sum assured of Rs. 10 lacs. Hence, if Ajay dies, his family would get Rs. 10 lacs, but if he survives, he would get the sum assured (Rs. 10 lacs) on maturity along with bonus declared. Let's assume that the yearly bonus every year is Rs. 40 per Rs. 1000 sum assured, or Rs. 40,000 per year. Hence, the final maturity amount would be Rs. 20 lacs (Rs. 10 lacs of sum assured and Rs. 40,000 for next 25 years).

Premium = Rs. 40,000 per year
Tenure = 25 years
Death Benefit = Rs. 10 lacs
Maturity Benefit (in case of no death) = Rs. 20 lacs

Now suppose Ajay has paid premiums for 2 years. So he has already paid Rs. 80,000.

At this point of time, Ajay comes to know that this is not the best policy for him. He also learns that if he surrenders the plan right now, he will not get anything, all his Rs. 80,000 paid will be a loss. This will surely alarm anyone and he would surely be de-motivated to stop the policy. He will try to minimize this loss and try to find out what best he can do about it. At this point of time, he wants at least the money he has paid back. This is more of a short-term pleasure-seeking activity and nothing else. Even though he knows that this is not the best thing for him, his inner self is shouting at him to not listen to anyone and keep paying. But he has a choice to make here. Let's see these two choices.

Life Insurance Policy

Rs.40,000 to be paid for next 25 years.

- **Rs. 10 lacs will be given on death**
- **Rs. 20 lacs will be given on survival**

Choice 1 - Continue paying the premium

In this case, Ajay will pay Rs. 40,000 per year for another 23 years, and at the end, he will get Rs. 20 lacs, but in the whole scene, he will be covered for Rs 10 lacs only. So he is happy in short term that there is no loss and through these 23 years, he keeps paying Rs. 40,000 in same policy.

Choice 2 - Dump the policy, and take a term insurance plan + invest in fixed deposit, PPF, or equity mutual funds

In this choice, he can take some tough decision and restructure things. Let's see what he can do here.

Let's first work on the life cover of Ajay, because in choice 1, his life insurance was really low and was not up to the mark. The primary thing is to get a decent life cover, so Ajay take a term insurance plan for Rs. 50 lacs for next 23 years. This should cost him not more than Rs. 5,000 as of today's standard (assuming his health is normal and he is not a smoker).

So out of Rs. 40,000, Rs. 5,000 goes towards his pure life cover; now he will be left with Rs. 35,000 per year after paying Rs. 5,000 for his life insurance. Assume that he invests this Rs. 35,000 in a PPF or fixed deposit account for the next 23 years. For simplicity sake, assume a return of 8% on PPF or equity mutual funds (current rates for PPF is 8.8% and equity mutual funds have given 15-20% returns over the long term like 15-20 years). We have chosen PPF and equity mutual funds, so that the maturity amount is also tax-free just like insurance policies. This is a fair comparison.

In this situation, the overall final value from his investment would be Rs. 23 lacs (Rs. 35,000 paid each year compounded at 8% for next 23 years). So at the end of 23th year, he will get Rs. 23 lacs and his life cover through the period would be Rs. 50 lacs. Now if you see:

Loss from Phase A (first 2 years) = Rs. 80,000
Profit from Phase B (next 23 years) = Rs. 23,00,000
Total Profit (Phase A + Phase B) = Rs. 22,20,000 with Rs. 50 lacs of life cover

However, in Choice 1, the overall gain was Rs. 20 lacs with a life cover of just Rs. 10 lacs. Now, numbers can be up and down a little and depending on future changes, one situation can better or worse than the other, but let's see what advantages Choice 2 has over Choice 1. In this example:

Criteria	Continue the policy as it is	Dump policy, take a term plan and reinvest the remaining money in PPF/fixed deposit
How much will Ajay's family get in case of death before 25 years	Rs. 10 lacs only	Rs.50 lacs + Value of his investments in PPF/mutual funds/FD
How much will Ajay get at maturity	Rs. 20 lacs approx.	Rs. 22 lacs approx. (this can change based on the interest rate on PPF or performance of mutual funds)
How much will Ajay's family get if they want their money in 15th year	Surrender value as per 15th year along with reduced bonus amount, should be somewhere close to Rs. 7-10 lacs.	Close to Rs. 10 lacs
What happens if Ajay wants to discontinue his life insurance cover in between	Not possible; he will have to either close the policy itself, which will impact his investment part. Or he can make the policy paid up. Both insurance and investments are linked here.	Just terminate the term plan. Because investments are not linked to insurance, the insurance premium money can be diverted to investments now.
What happens if Ajay wants to partially withdraw money from his policy and keep the policy in force too?	He can take a loan on the policy, but there are limits and restrictions.	If invested in PPF, he can partially withdraw after 7 years. If invested in FDs, he can break the FD and take the amount. If invested in mutual funds, he can redeem the units anytime he wants.
Effort Needed	Nil - Just continue what is going on. Looks extremely tempting	High - Effort required to take a term plan, start the investment and get out of your comfort zone. Not for everyone!

Note - The alternate investments taken was PPF / fixed deposits / equity mutual funds. If invested in equity products, the results can be much better in Choice 2 as returns from equity in the long term are very good.

You will realise that this comparison is valid only when a person is in the initial phase of his traditional insurance plan. If a person is at the last phase of investment tenure and a big part of his policy tenure is over, it would make sense to make the policy paid up or just continue the policy, because the initial time is lost and the remaining time is not much (phase B). And it will be really tough to find out an alternative that will deliver enough returns to offset the loss by surrendering the policy (phase A).

So if you are doing this comparison, better do the math and find out which situation works in your case. Focus on other aspects also like liquidity, partial withdrawal aspect and simplicity. Returns are just one aspect and a much overemphasized factor by product sellers, but in real life, many things matter. Coming to the point, here is an indicative action item table that you can use, but make sure you do the calculations yourself before taking any action.

Paid very few premiums (1-3) for the policy	Stop the policy
Paid 4 - 7 premiums	Make it paid up and don't make further premium payments
Near to maturity	Continue the policy

So coming to your personal case now, you have understood how to think about the life insurance policy and what factors to look at while cleaning up. List your policies and make a note of which policies you would like to discontinue and not pay further premiums.

Bad policies are an opportunity

When we do this exercise with our clients, some of them feel very sad that they took such a wrong decision and wasted so much time and money on bad policies. But then we tell them that they should look at them as opportunities. They have to look at the scenario after they stop the bad policies. We tell them how the premium they were paying for their policies will suddenly be “available” for them, and they will now have additional money (which they were putting in these policies), which can be used for other meaningful purposes like funding their financial goals. If one was struggling to generate those premiums, at least now he will not have that pressure in his life.

Your situation vs. your parent's situation

The world today vs. your parent's world is very different. There was a time when there were only traditional life insurance policies, there was a time when life was not that complex, there was a time when you had enough people to take care of your loved ones in case you weren't there, and there was a time when a small cover was enough for your family.

Not anymore!

Times have changed and what looked like a good product to your parents might not fit you! Traditional life insurance policies were at one point of time the only option to invest for a common man, but not anymore. There are numerous alternatives and much better ones at that. So don't get the notion that a product is always bad or always good. It depends on the time and the situation.

Now let's move to the final task.

After most people start their career, in a few initial years, their net worth is not more than Rs. 5 lacs, Rs. 10 lacs or at best Rs. 20 lacs, so these kinds of numbers look good to them. When they buy a policy, these numbers look big enough, because they generally look at the return from the policies.

But is it big enough to replace you?

This person does not look at the life insurance number deep down, nor does he question how much help it will extend to his family for their whole lives. Note, you will never come back, and your family will be there for next 30-50 years at least. Other than having food 3 times a day, is there not much to achieve in life? Assuming that Rs. 10-15 lacs will be enough for them is a joke in today's world. I am assuming you still have a home on loan or don't have a home at all and you also don't have a great bank balance to show off.

So "how much life insurance to have?" is a simple function of what all you want to make sure for your family. Your ideal life insurance should be a number that can:

1. Meet your family expenses for several years.

2. Pay off your liabilities + loans, so that your family can concentrate ahead and not get tangled in these issues.

Now one way of doing this is through mathematical calculations; but do you want to really reach that perfect number? Do you want to be too precise? Because that would call for some calculations, but a more simpler way of doing it is to approximate. The best thing about life insurance approximation is that the approximate numbers are as powerful as the perfect numbers. Think about it, with calculations your life insurance number was Rs. 1.43 crores. Now suppose you take a life cover of Rs. 1.5 crores or Rs. 1.2 crores, do you really think that's a blunder? Do you think that's wrong planning? No!

The whole idea is to get "decent" life cover". Rs. 1.43 crores, Rs. 1.2 crores and Rs. 1.5 crores are all decent numbers and any of them is fine. It should just make sense and justify your case. So let's approximate using this table assuming your situation.

We will assume 3 things.

1. E = your family yearly expenses in your absence (because you are not around)
2. Inflation you want to assume in long run (depends on how pessimistic you are about future inflation)
3. Returns earned by the insurance money that your family would put in some investments (preferably a fixed deposit most times).

Let's assume that you want to plan for next 30 years. Hence, the life insurance requirement would be:

Insurance Requirement Table

Inflation/Return	6%	8%	10%
6%	30 times	24 times	20 times
8%	40 times	30 times	25 times
10%	50 times	40 times	30 times

all the numbers are approx

Now calculate the life insurance amount you need from this table. The best thing is that this number also takes care of inflation. So, the assumption is that your family will invest the money and expenses will be withdrawn from the pool of money each year, as the expenses will also increase as per inflation.

Example

Ajay's family's monthly expenses in his absence are Rs. 30,000 per month or Rs. 3.6 lacs per annum. He also knows that his family would put the insurance money into a fixed deposit, which will have an average return of around 8% per year. He also wants to factor in inflation of 8% over that period. Now if you see the table and match the returns (8%) and inflation (8%) column, you can see that it's 30 times. So it would be 30 X Rs. 3.6 lacs = Rs. 1.08 crores.

Ajay also has a liability of Rs. 20 lacs of outstanding home loan, and Rs. 40 lacs worth of investments in FD and cash in the bank .So his final life insurance would be Rs. 1.08 crores + Rs. 20 lacs - Rs. 40 lacs = Rs. 88 lacs. Now this is a good enough life cover covering different aspects of his financial life. He can safely get this cover in Rs. 10,000-20,000 per annum. Higher the age, higher the premium.

If you see carefully, this Rs. 88 lacs figure is just a number, which is a "good number", though we tried to reach it using some logic. Still, if I were to tell his situation to you, you would say around Rs. 1 crore is a good amount of life insurance for him. Truly speaking, a person can just choose a number out of Rs. 50 lacs, Rs. 1 crore, Rs. 1.5 crores and Rs. 2 crores. Choose the one which looks logical to you and that you can mentally justify will help your family if you are not around. Don't look for perfection; it leads to delays. This table is so simple that you can instantly do your planning.

Don't focus too much on the perfect number. All you need is a decent life insurance cover, which can deviate a little here and there. Don't pause your actions because of this.

Checking your life insurance

Your family's current yearly expenses (E)	
Inflation you want to assume (6%, 8%, 10%)	
Return on Investments assumption (6%, 8%, 10%)	
How much times you need Life Insurance based on table above (F)	times
Insurance requirement (I) - E x F	
Your current liabilities (L) (all outstanding loans)	
Existing life insurance, which you will continue further (A)	
Existing Assets and Different Investment which can be used by family (better not include the house you live in) (B)	
Final Insurance Required (I + L - A -B)	

Final Outcome

Now let's see the results of this chapter and what changes happened in your life insurance.

Criteria	Before this Chapter	After this Chapter
Total Life Cover		
Premium Paid		
Premium Paid per Rs. 1 lac cover		
Number of Insurance Policies		

Bonus Tips

- Most term plans give a premium incentive for higher sum assured policies, so the premiums are generally cheaper for more than Rs. 50 lacs of sum assured. So, it makes sense to go for higher cover like Rs. 50 lacs or Rs. 75 lacs. At times premium for Rs. 40 lacs of term cover is higher than Rs. 50 lacs. So do check it out.
- You can surrender your policies by sending a surrender letter through post, which most companies accept. This will be helpful if your original branch is not in the same city where you currently live.
- In case of LIC policies, you can also get some information by SMS itself. All you need to do is SMS **"ASKLIC <Policy No> PREMIUM/REVIVAL/BONUS/LOAN/NOM" to 56677** and you will get an SMS back with the relevant information.
- When you buy online term plans, most companies give an option to do medical check-ups at home and this way you won't have to personally visit any place.
- You can divide your cover into two companies (suggested if both of them are above Rs. 50 lacs). That way if you want to decrease your cover after some years, you can just stop one of them, it's as simple as that.

Bonus Step

How to be ready for the future

We're almost there! The book is almost complete, but I want to make sure that you understand a few rules so that you can lead a great and fulfilling financial life. The 10 steps we have learned during this journey were more geared towards planning and organising your financial life.

I'd like to give you a few tips on how to condition your thinking so that you can take better decisions in your financial life. So, I am going to reveal 2 great concepts that I developed while working with hundreds of clients and thousands of my blog readers. I call them:

1. 3 Layers of Financial Life

2. 5 Point Decision-Making Process

I guarantee that once these two concepts are drilled in your head, you will always make a great financial decision in your life!

3 Layers of Financial Life

Have you ever looked at a 3-storey building?

Of course, you have!

But did it occur to you that if you did something to the uppermost storey, the first and second storey would be relatively unaffected? There would definitely be an impact, but they wouldn't crumble to dust.

However, if you break the first storey, the building will be destroyed. The second and the third storey will come tumbling down because the base is gone. Similarly, destroying the second storey will not affect the first storey as much as it would affect the third storey.

And there is your first lesson! Your financial life is like a three-storied building, with three layers that are undeniably interlinked. Understanding this concept is essential to empower your decisions and bring some clarity for when you are confused about anything or anytime in your financial life. The three layers are:

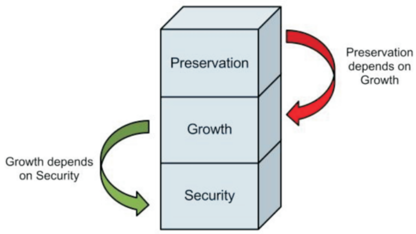
Security: Whenever we buy a product to insure us from untoward events in our life (that costs money and impacts our wealth), we are actually building our "security" layer. These include life insurance, health insurance, home loan insurance, critical illness cover, accidental cover and even emergency fund creation.

Growth: Any action you take that helps you grow your money over time builds your "growth" layer. I don't mean "grow your money" in terms of numbers, but about growing your money in real terms, increasing its purchasing power and ensuring that your money increases even if you account for inflation and taxes. Many people feel that just because they have invested in some traditional policy, their money is growing, which is not true. The money they will get at the end will not be enough after considering inflation and taxes. If you invest Rs. 1 lac into something and it gives you back Rs. 2 lacs after 10 years, the value has grown, but not its worth, because Rs. 2 lacs after 10 years will be able to buy less than what Rs. 1 lac can do today. That's why understanding this distinction is very important. Any investment product that grows in value over time falls in the growth category.

Preservation: Preservation is when you take an action to preserve your money. All of us, at some point of time, want to make sure that our money is 100% safe so that we can fulfil our dreams. When we need it, the money should be available. It is more important to preserve it rather than grow it. Generally, when our retirement or a financial goal is near, the focus shifts to preserving money.

Relation between preservation, growth and security

If you think for a minute, you will recognise that security, growth and preservation are the 3 pillars of your financial life that are inter-related. A bad planning decision or ignoring the care of one pillar can impact the other pillars very badly when things go wrong.



Imagine you have taken great care in investing your money in products that give you very good returns, such as a great policy, or stock, or a mutual fund, and your money is growing; then you have taken very good care of the growth part of your financial life. But suddenly, the breadwinner suffers a fatal accident and that's when you realise that nothing was done in the area of **security:** no health insurance was taken.

You now see the problem of focusing solely on growth. Those investments will be of little use because a big chunk of wealth will now go in funding the hospital cost. Or even worse, if the family's sole breadwinner has an untimely death, then all those investments made with only **growth** in mind will shrink over time and eventually end, as the family keeps dipping into them to meet their expenses.

Now imagine a case where a person has taken good care of the **security** aspect, but ignored **growth**. All his life he has invested in only traditional insurance policies or fixed deposits, but over the years inflation has made sure that the amount of wealth generated at the end is just not enough considering the high costs of everything. Now that he is retired, he will consume from the wealth he has generated; this is preservation time for him and he has to live with that money only. Do you think preservation will happen properly? No. He has 100 units of wealth and uses up 10 units each year for his daily needs, but his wealth can add just 5% into itself because of interest. In that case only 90 units will remain after first year and 5% of it (4.5 units) will be added back to it and it will become 94.5 units, but again 10 units will be consumed again next year (or 11 units due to inflation). Do you see where we're going with this? His money is going to run out soon. This happens because he did not focus on growth in the early days of his working life. If he had grown his wealth to 300 units or 400 units, it would be a very different picture. Instead of living in the fear of "How many more years will my money last?" he would have been tension free. In short, **preservation** is possible only if **growth** is good.

Both examples highlight the close dependency between security, growth and preservation. "Security" is the first floor and the base of your financial life. If you have taken care of "security", your growth will not be impacted or least impacted by misfortunes. If you have focused properly on "growth", then "preservation" will automatically fall in line.

So, make sure that you take care of each floor of your financial life.

Now complete the following exercise. List all the actions you have taken for security, growth and preservation and rank yourself on all the 3 areas.

Where have I invested for "security"?

What I have done until now?	What do I still need to do?
1.	1.
2.	2.
3.	3.
4.	4.

Where have I invested for "Growth"?

1.
2.
3.
4.

Where I have put my money that is doing "Preservation" and not "Growth"?

1.
2.
3.
4.

How do you rate yourself on all the areas out of 10?

Security	
Growth	
Preservation	

5 Points Decision Making Process

I once asked a reader named Animesh on my blog to share about his financial life, what was working and what was not.

This was Animesh's response

Thanks for replying. Regarding my financial life, I am really frustrated with many things that happened in my life. An agent sold me a ULIP product whose worth is just Rs. 42,000 right now after 3 years even though I have paid Rs. 20,000 per year for last 3 years. That's a total of Rs. 60,000 that I have invested and that idiot never told me that it would be invested in stock markets.

And just last week I found out that I can't surrender by Endowment Plan before the 3 years are up, otherwise I won't get anything. Now I will surrender it after 5 years, but still they say I will get just 90% of my money. This is not supposed to happen to investors like us. It's our hard earned money, and why they are deducting 10%, I have no idea."

And my credit card, oh my god... I just don't understand that even after paying my minimum balance religiously, why my credit card debt does not come down. I am so worried and frustrated at times about all this, not sure whom to catch and whom to complain about all this. I am just not getting what to do.

This might look like a very normal reply from someone who has been really struggling in his financial life, because others cheated him. Fair enough. But before I comment on this, let me share a story with you.

The bet on Blacky!

A man was once passing through a racecourse. He saw an old friend there and started talking to him about betting. His friend told him how he could make a lot of money if he bet on a horse and it wins. They chose a horse called "Blacky", an amazing black horse that appeared promising. The guy standing near the horse claimed that there was no horse like Blacky in the entire region and that he had won a lot of money on the same horse many times. This was enough for both friends to decide quickly that Blacky was indeed the right choice.

The race started. In the first half, Blacky was ok; sometimes he was ahead, sometimes he fell behind. It seemed like a close finish, but towards the end Blacky didn't figure in the first 3! On this side of the fence, the friends who had bet on Blacky were jumping with horror and excitement. They poked each other in excitement, pulled their hair out and at times, jumped on the seat. Despite all the yelling, shouting and screaming, Blacky lost the race.

The man who lost his money came out of the racecourse and as he walked, his eyes fell on a board containing all the horses' bio data, history, genetic information, stamina information, their wins and losses, and the average rank of each horse. It even had what each horse ate last night and the last time they fell ill!

Now my question to you is - **"How many Blackys have you betted on in your financial life?"**

What does this story teach us about the way we buy our financial products? The wise man in the story was jumping and shouting and pulling his hair when the race was on - do you think it has anything to do with the horse's performance, do you think his acts will increase the chances of the horse winning?

How would you have avoided betting on the wrong horse? Simple, do your homework. Read up on the financial product that you want to invest in. Understand the brochure, ask questions and only then invest. But wait - don't think that doing your homework will get you the best return and guarantee that you can never lose the money. It will only make sure that you become responsible, that you don't complain later about what you did and you are more accountable to yourself, because you chose it yourself. You have bought it after understanding what it is and how it will serve your financial life; it has a purpose in your financial life. Obviously, it increases your chances of getting a better outcome out of the financial product.

What is the "homework"?

When I say do your homework before you buy a financial product, you need to look at only 5 things. If you are clear about those 5 things, I can make sure you never complain or have any worries after buying that product.

5 points to look at before buying any financial product

1. Return

The biggest thing that people complain about financial products is that they are not getting the right kind of returns they expected. For example, if you are buying a policy with sum assured of Rs. 10 lacs and the premium for 20 years is Rs 50,000. At the end, you will get the sum assured of Rs 10 lacs plus a bonus of Rs. 45 per Rs. 1,000 sum assured (that's Rs. 45,000 per year). In that case you will get Rs. 10 lacs (sum assured) + Rs. 9 lacs (bonus) = Rs. 19 lacs at maturity. Now many people just don't know the returns. They think they will pay Rs. 5 lacs, they will get Rs. 7 lacs and the life insurance is additional, so they feel it's a good deal. But if you wonder about the percentage return of this policy, at the end, on a compounded per year, then it turns out to be 5.78%.

Most probably, you know how much you have to pay over the years and what you will get from the policy in different years. If not the exact amount, then you at least know a rough projected amount. So, you can use these numbers and find out the exact return. The tool for doing this is called IRR (when payments are on fixed duration) or XIRR (when payments are at irregular intervals). Watch http://www.youtube.com/watch?v=iJ6Y8qxZu3o to learn more about IRR and XIRR.

It is essential to use IRR or XIRR to calculate the returns of a financial product, before buying it, no matter what the agent or your advisor says.

2. Risk

The second thing that people complain about is risk; this is mostly related to the value fluctuations in their investments or any other kind of risk in their financial product. This happens again because of not understanding the nature of investment and relying too much on the words of the person who sold it to you.

I see many people complain about their investments worth going down in value compared to what they have invested. For example, a person pays Rs. 20,000 per year for 3 years in a ULIP and after 3 years, his total investment is worth just Rs. 45,000 only. In the midst of complaining about everybody, he forgets that he never bothered to find out that the underlying investment was done in equities (stock market), which is bound to fluctuate. His timing was unlucky because the markets started plunging from the point he bought the product. In these cases, not understanding the final asset class where the money is being invested creates the problem.

So understanding the risk element in the financial product and how the overall value can go up and down is very important. Suppose I suggest a fancy mutual fund that appears promising. Clearly, “appears promising” is not a strategy when it comes to your investments. You need to know where that mutual fund is investing finally or how they choose the stock (do they pick cheap Rs. 20 stock hoping that it will soar to Rs. 200?). This can give high returns, but the risk too will be high. This mutual fund surely stands a great chance of vanishing returns, even in a bullish market.

Now the risk here in this example is not that the fund is investing in cheap stocks, but “not understanding the risk”. If you know what is happening in a financial product and then invest in it after that, then there is no risk, because you have accepted it, you have said - “fine, I invest after knowing what can happen in the worst case”. And when it happens, it’s not a risk; it’s just the occurrence of that event that you know could happen.

3. Costs

Costs are a major pain point for investors, because the maximum complaints are about "hidden costs". When they are not aware of the costs and later they find out, they feel cheated, they feel that had they known about it, they would not have invested at all. Many times, they make wrong assumptions about a product's performance. If you invest in a high-cost financial product A and low-cost financial product B, your returns will vary in both. For example, when you invest Rs. 10,000 in A which has costs of 20% of first year premium, actually only Rs. 8,000 will be invested and with 50% return, it would just be Rs. 12,000 - translating into a 20% return on investment for you. However when the same Rs. 10,000 is invested in B, which has 0% cost, then all Rs. 10,000 is invested and even with 40% return, it will become Rs. 14,000 and the final return for investor will be 40%. You can see that Fund A was superior in performance giving 50% compared to performance of B which was just 40%, still Fund B has generated better returns for investors (40%) compared to A (20%). This was because costs have eaten up a part of returns from Fund A.

How long does it take to find out the cost structure of a product? Very less! Most likely, a product will have its brochure on the internet. Download the PDF brochure, go through it and locate the costs. You will mostly see all the costs and rules relating to penalty etc.

You should know that there are several costs associated with different kinds of products like:

ULIPs	Mortality charges, fund management charges
Term plans	Mortality charges
Mutual funds	Expense ratio, exit loads
Demat account	Yearly maintenance charges
Credit cards	Yearly charges, renewal charges

4. Liquidity

Almost 99% of endowment policyholders do not know at the time of buying how much they can withdraw before the maturity period is over. This becomes critical when they discover how illiquid the product is in an emergency. You may know what happens if you invest right now, but if you want to break the policy and get back your money in next 1 year, 2 years, 5 years etc., what are the rules, what will be cut and how much? Will you lose the taxation benefits for previous years?

This situation arises because many people buy financial products as if they are buying vegetables on the street, randomly, without much thought and planning. And they are not clear if they can afford the high premiums for all the years or not. In my last company, this guy told me he was investing in a cool product with a Rs. 50,000 per year premium. His salary was Rs. 6 lacs per annum that time; he had just started the job and was excited to INVEST. I knew he was thinking short term. The premium amount was looking small to him right now; but he had not thought carefully if he could invest that same Rs. 50,000 per year for the next 20 years.

Obviously, it became a big payment after 3 years when other expenses cropped up. In the 4th year, he had to borrow money to pay the premium and in the 5th year when he just could not pay, he decided to surrender the policy. Now, he had paid Rs. 2 lacs over the last 4 years, but he got back Rs. 52,000. He was almost in tears and frustrated. It was not a flaw in the product, or the premium, or his situation. He was the problem; he had not understood the liquidity part of the product. You can get the liquidity aspects of any financial product easily in the product brochure. Or just search over the internet about it.

5. Purpose

“If you don't find a purpose for your money, it will find its purpose on its own.”

The last and final point is that you should always ask yourself the purpose of an investment before purchasing it. Always assign a financial goal to that investment. If you are purchasing a life insurance policy, tell yourself that it’s for your family protection in case you are not around. If you tell yourself that it’s for tax saving, then the chances of forgetting to pay the premium is very high.

If you are investing in a PPF account, tell yourself that it’s the debt investment for your retirement that will be used after 15 years. Don't tell yourself that you are opening it just because you read it’s a “good” investment option.

When you assign a financial goal to an investment, it becomes more important and you feel more accountable towards it, your commitment rises for that investment. Let me explain with an example:

Suppose you start a monthly investment (SIP) of Rs. 5,000 in 2 mutual funds. After 3 years, they are worth Rs. 3 lacs.

Now there are 2 cases:

Case 1: You have assigned it for your house down payment or child’s education

Imagine you feel like going on a vacation for a week OR you want to upgrade your car just because all your friends have upgraded to a new car. Will you dip in that investment you are doing for your house down payment due in next 2 years or your child’s education that can start anytime soon?

No! Your reaction will be that the investment is for something very important; the label on the investment stops you and keeps your guilt fresh!

Case 2: You have no financial goal assigned to the investment

In this case, the Rs. 3 lacs you have in your mutual funds is just some wealth you have grown by luck, it has no purpose, and because it has no purpose, using it to fund a short-term purpose like a vacation or upgrading your car seems to be the right option. You tell yourself, "I will make sure I fill the gap soon," which is unlikely.

Did you see the behavioural change? Did you see how easy it was to utilize the investments in this case? When you declare the purpose of the investment with a meaningful goal in your life, it is psychologically not easy to waste it on trivial needs.

Once you go through these 5 exercises before buying any financial product, you will never complain or worry about that product!

Example

Let's take a money back plan, a popular product in everyone's portfolio. Start rating the 5 areas we discussed and assign a rank from 0 to 10 in all those 5 areas, where 10 means you are very clear about that area. Here is an example:

Return	6
Risk	4
Costs	3
Liquidity	2
Purpose	4
Your Average Score	3.8 (19/5)

So, if you look above, your average score is just 3.8 out of 10 (19/5), a poor score. Aim for an average score of anything more than 7 or 8. That means you are very clear about all the 5 aspects of a financial product. Start by filling the table:

Product	Return	Risk	Costs	Liquidity	Purpose	Your Average Score
Product 1						
Product 2						
Product 3						
Product 4						
Product 5						

If you score less than 7 on any of your financial products, it's time to spend some time reading up. Best of luck!

Click Here to Buy the Book

Testimonials

What many people don't know is that financial planning is not a art form done by professionals but science which can be mastered by anyone who reads and understand it. This very concept is put down in word by Manish in this book.

This is a book that can be read and taught. Why does it stand out is the way it is presented to the end users. The real life examples and learning from mistakes is what this book portrays. As people of knowledge would say "learning from ones mistake is good and learning from others mistakes is even better"

Here the author shows how people have failed and how could you learn from it and make it correct by simple steps he has listed out one after another. All one has to do is simply copy these steps into their life goals and plan it accordingly. You shall attain the ultimate goal of financial freedom and that is just what you want if you are reading this review. Invest the time in the book(its a easy 1 week read for a even slow reader like me) and follow the guidelines you will get what you were looking for when searching in this book

Prabeesh Raman

This is an awesome step-by-step guide to take control of your financial life. Manish has a very engaging style and pulls the reader along with him. This is an action book! Meaning you don't wait until you finish the book. Read each step complete the steps and then move on to the next step (don't take too long though!).

This is the best way to reap benefits from this book. If you want to change your financial life and want a step-by-step guide/exercise book this is the one to buy.

M. Pattabiraman