



# **THE NEWSMAKER**

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### **ARE THE DAYS OF ULIPs NUMBERED?**

*by Suresh S.*

**Director, DMS Financial Services Co. (P) Ltd.**

THE BUDGET has maintained further silence on the fate of the Direct Taxes Code and merely announced shifting by one year the implementation.

One of the important changes it had proposed last year, was with regard to Life insurance where under EET the final amount withdrawn becomes taxable.

The relevance of this is even stronger for customer purchasing ULIPs. Where the investment of a part of the premium is made through the Insurance Company in the stock market, the beneficiary stands to gain at the time of completion of the policy, the capital gains on the investment. ULIPs are a favoured route for many individuals to get returns without having a tax liability.

Under the EET regime the entire amount becomes liable to income-tax. This reduces substantially the returns on the investment.

Most times individuals do not seek life cover per se. They seek products that combine life cover for two reasons: i) presence of Investment features and ii) tax benefits. Their motivation stems from the fact that they earn returns on the investment by paying marginally higher premium as compared to pure Term products.

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Of these two reasons, the tax advantage is stronger. This is because even as Investment Avenues returns from products of Life insurance companies are not significant.

Take the illustration of a person who at the age of 41 takes ULIP paying a premium Rs. 50000 per annum for 10 years and sum assured is Rs.250000. The policy can be 'live' for 29 years that is upto his reaching the age of 70 but he can also withdraw the proceeds after 10 years when he completes paying the required periods of premium. The premium amounts after appropriating for Initial, mortality charges etc., is invested in a conservative Fund which has Equity shares as a small portion of its portfolio. (See Table below)

| <b>Age</b>   | <b>Premium<br/>(Rs./lakhs)</b> | <b>Fund value<br/>including<br/>bonus<br/>(Rs.lakhs)</b> | <b>Surrender<br/>value<br/>(Rs.lakhs)</b> |
|--------------|--------------------------------|--|---|
| 41           | 0.50                           | 0.44   | 2.50                                      |
| 42           | 0.50                           | 0.97   | 2.50                                      |
| 43           | 0.50                           | 1.56   | 2.50                                      |
| 44           | 0.50                           | 2.22   | 2.50                                      |
| 45           | 0.50                           | 2.93   | 2.93                                      |
| 46           | 0.50                           | 3.69   | 3.69                                      |
| 47           | 0.50                           | 4.52   | 4.52                                      |
| 48           | 0.50                           | 5.43   | 5.43                                      |
| 49           | 0.50                           | 6.40   | 6.40                                      |
| 50           | 0.50                           | 7.46   | 7.46                                      |
| 51           |                                | 8.08   | 8.08                                      |
| 52           |                                | 8.76   | 8.76                                      |
| 53           |                                | 9.49   | 9.49                                      |
| 54           |                                | 10.28  | 10.28                                     |
| 55           |                                | 11.14  | 11.14                                     |
| 56           |                                | 12.07  | 12.07                                     |
| 57           |                                | 13.08  | 13.08                                     |
| 58           |                                | 14.17  | 14.17                                     |
| 59           |                                | 15.35  | 15.35                                     |
| 60           |                                | 16.63  | 16.63                                     |
| 61           |                                | 18.02  | 18.02                                     |
| 62           |                                | 19.53  | 19.53                                     |
| 63           |                                | 21.16  | 21.16                                     |
| 64           |                                | 22.93  | 22.93                                     |
| 65           |                                | 24.84  | 24.84                                     |
| 66           |                                | 26.91  | 26.91                                     |
| 67           |                                | 29.16  | 29.16                                     |
| 68           |                                | 31.59  | 31.59                                     |
| 69           |                                | 34.23  | 34.23                                     |
| <b>TOTAL</b> | <b>5.00</b>                    | <b>34.23</b>   | <b>N.A.</b>                               |

|            |  |  |  |
|------------|--|--|--|
| (Rs/lakhs) |  |  |  |
|------------|--|--|--|

The amount he would get as proceeds at age of 70 look impressive but the IRR based on cash flows shows that the returns are not impressive. The individual in fact is better off by choosing to withdraw after completing ten years of payment of premium. What makes the proposal interesting – assuming the individual survives the term – is the impact of tax saved. The individual is assumed to be saving 30% on the yearly premium amount of Rs.50000 for 10 years. The EEE model is assumed. These are given below:

| Option                               | Proceeds at that time | IRR (%) |
|--------------------------------------|-----------------------|---------|
| End of 29 years, ignore income-tax   | 34.23 (Rs./lakhs)     | 8.41%   |
| End of 10 years, ignore income-tax   | 7.46 (Rs./lakhs)      | 8.62%   |
| End of 10 years, consider income-tax | 7.46 (Rs./lakhs)      | 15.99%  |

With an EEE model the returns are a max of 15.99%. This is not something very exciting but it is a good tax-planning device. If however the proceeds will get taxed at the time of withdrawal, it will squeeze the returns. It is very obvious that a EET model will dampen the appeal of ULIPs.

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## **ASSET RECONSTRUCTION: INDIA SHOWS THE WAY**

***Compilation by Suresh S.***

Gross NPAs of Banks in India have declined by 50% to 2.3% in 2008 from 4.6% in 2002. This is a pointer that the experiment has succeeded.

ARCs in India are a unique model unlike their Western counterparts.

### **Abroad:**

- ARCs are centralized govt. agencies.
- They enjoy special powers to cut short legal procedures and negotiate for wholesale deals for NPAs.

### **In India:**

- ARCs are private sector units.
- They do not enjoy special powers.
- They bid for NPAs in a transparent clearly defined process.
- Payment is made by Cash or Security Receipts.

The only weapon they additionally possess is under the SARFAESI Act, they can do ‘proper management of the borrower’s business by effecting a change in, or takeover of, its management.

This is covered by RBI's draft guidelines. (One more guideline expected is 'sale or lease of a part or whole of the business of the borrower').

**Challenges faced by ARCs:**

- ❑ Debt aggregation
- ❑ Source funding from co-investors
- ❑ Determining acquisition price
- ❑ Speeding up the recovery process

On acquisition price the Indian model has demonstrated its efficacy:

- ❑ IBRA, the Indonesian ARC acquired assets practically at zero value
- ❑ KAMCO, the Korean ARC, acquired assets at a discount of 64% to the appraised value, which is 3% of face value
- ❑ ARCIL, Asset Reconstruction Company of India has an acquisition price-to-face value ratio of 25.7%

If they can now demonstrate that they are also good at Rehabilitation/turnaround, they would be a role model for other countries to look up to.

Ref: The Economic Times, Mumbai dated Mar.25<sup>th</sup>, 2009, under 'Money & Banking', author 'Rajiv Ranjan, President & CEO, Reliance ARC' titled 'Mastering the art of asset reconstruction'

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**Services offered by DMS Financial Services Co. (P) Ltd.**

- Outsourcing in the financial function
- Placement of human resources
- Training in finance, sales, operations and soft skills

**For details, please contact Mr.Karthi on 044-24995672.**