Financial Planning to Make Our Retirement Years Golden Ones

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INTRODUCTION

Ask anyone about the importance of planning for their retirement and the answer is a resounding "Yes, it is important". Yet, no matter how crucial retirement planning is, most people do not seem to have the urgency to equip themselves with a proper retirement plan that will see them through a financially secure retirement. There is a reluctance to plan for the future as retirement often seems to be a faraway notion but the reality is that it will come sooner than we think. The adage that "people don't plan to fail but fail to plan" is a good reminder that our retirement future needs to be addressed now with a proper retirement plan and action in order to ensure that the future does not come as a "surprise" but that we have the ability to influence it now.

In trying to understand the mindset of Malaysians on the subject of retirement and why they lack interest in taking control of their financial future, the Private Pension Administrator Malaysia (PPA), has found five common excuses which are based on unfounded assumptions or myths concerning retirement and retirement planning. These, together with a lack of urgency often lead people to procrastinate taking action now to secure their retirement plans.

THE 5 RETIREMENT MYTHS

Myth #1 – My EPF is enough for my retirement

Malaysians have the mindset that their Employees Provident Fund (EPF) savings will be enough to take care of them through their retirement years. The common assumption made is that their EPF contributions will be adequate for them to replace their earned income when they retire. However, people should take note that their EPF contributions may or may not be sufficient to replace their earned income. EPF statistics for 2011 show that a whopping 72% of EPF members who are at the pre-retirement age of 54 have savings of just RM50, 000 and below. Coupled with that, 50% of retirees spend their entire EPF savings within 5 years.

Myth #2 – My children will care for me when I retire

Many people make the assumption that their children can take care of them during their old age; however, due to the escalating cost of living, some children find it difficult to even provide for their own family, what more for their own old folks.

Myth #3 – It is too early / late to start saving for retirement

Some people think it is too early for them to start saving for retirement. Others think it is too late and they cannot do much even if they were to start now. There never is a perfect time, but is it necessary to start. Everyone should aim to have their money work harder for them. Think of the benefits of compounding interest. Starting a retirement nest egg early, even when you are in your 20s, gives you the full benefits of compounding. No matter when you start saving, time and the wonder of compounding are your best friends when it comes to retirement saving.

Myth #4 – I can still work after I retire

Working in your golden years is a matter of preference. Choosing to work after retirement is one thing, but being compelled to work just to survive is another. If you run out of funds, you will find yourself in the unfortunate position of having to work. And there is no certainty that you will find a job.

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Myth #5 – I can spend less when I retire

People have the impression that they can cut back on their expenses when they retire. But in reality, if someone is already used to a certain lifestyle, it is not easy to adjust. In addition, we live in a rising inflation environment and medical cost is continuously increasing, making it imperative to plan our finances adequately for retirement.

THE BIG RETIREMENT PROBLEM

Research has shown that the reason many people around the world do not plan adequately for their retirement and arrive at their retirement with little or no wealth is mainly due to the lack of financial literacy and being woefully under-informed about the basic financial concepts. Financial illiteracy may stunt people's ability to save and invest for retirement, undermining their well-being in old age. Experts often point to poor financial decision-making as a cause of the retirement security crisis and which renders retirees the most vulnerable to economic hardship in retirement. The problem becomes more critical as retirees move away from professionally managed pension toward do-it-yourself financial planning. This is telling as statistics show more than half of retirees in Malaysia spend their entire EPF savings within 5 years. It is easy to fall into the trap of depleting one's retirement savings if one treats the savings as a windfall and not keep it invested to garner passive income.

While the above retirement issues have been commonly raised, the lack of interest and urgency in people to take planning for their retirement seriously suggests that there is a need to bring the retirement issues to a personal level whereby individuals can find out for themselves what they need to focus on to properly plan for their retirement. PPA has come out to help individuals plan for their retirement by focusing their attention on 3 main issues that must be addressed now; otherwise, they may contribute towards making retirement a big problem later.

ADEQUACY – HOW MUCH IS CONSIDERED ENOUGH AS MONTHLY INCOME FOR RETIREMENT?

Firstly, people need to ask whether they have adequately planned for their retirement income to replace their earned income, so as to continue to enjoy their current standard of living. The rule of thumb is 2/3 replacement income ratio of our last drawn salary, i.e. if a person earns RM10,000 before he retires, he will need about RM7,000 as his monthly retirement income to continue to enjoy relatively the same standard of living he has become accustomed to. How much a person needs for their retirement - whether it is RM800 or RM8,000 - really depends on their pre-retirement lifestyle, health situation and family dependents. Without sufficiently replacing their earned income when they retire, retirees will have to cut back on their living standard or fall into dependency on others to take care of them especially if they are no longer fit to work to earn their own income.

SUFFICIENCY – HOW LONG SHOULD YOUR RETIREMENT FUND LAST?

Secondly, people need to ensure that their income is sufficient to last them for the whole duration of their retirement years. The key issue here is outliving your retirement funds, which would leave people very vulnerable and running out of income to support themselves when they are older. Malaysians are living longer. The current average life expectancy of Malaysians is about 75 years and this number is expected to increase to beyond 80 in a few years to come if medical marvels continue to keep us healthy. This means that with the current retirement age of 60, on average, Malaysians would have to allocate enough savings to sustain 20 to 30 years of their retirement life so they do not have to outlive their savings.

SUSTAINABILITY – HOW DO PROTECT MY RETIREMENT FUND AGAINST INFLATION?

Finally, people need to have retirement income inflation adjusted. Inflation has a subtle and quiet way of increasing the cost of living and eroding our purchasing power. While RM1 million seems a lot today, it may not buy a lot ten years down the road. As such, we need to make sure our money works hard for us by ensuring the growth rate of our retirement savings and investments is higher than that of inflation; otherwise, inflation will erode the standard and quality of our retirement life over time.

If the concerns of adequacy, sufficiency and sustainability of retirement income are not addressed now with proper planning for retirement, people will be leaving it to chance that "things will turn out all right" for them when they retire. Leaving one's retirement to chance may put one in financial jeopardy, resulting in old age dependency and poverty. It is with this in mind that the PPA is addressing the issues of inadequacy of savings among the elderly, longer life expectancy, inadequate savings due to shorter period of savings and longer period of spending by promoting awareness and education to empower the public to take control of their retirement lives. For these reasons, the Private Retirement Scheme (PRS) was launched to promote saving and investing adequately to the public. Malaysians now have two pillars for their retirement, namely the mandatory EPF scheme which is the 1st Pillar and the voluntary PRS scheme which is the 2nd Pillar. In time to come, every working Malaysian ought to have two retirement schemes that will provide financial security for their retirement.

To address the three big retirement income problems of adequacy, sufficiency and sustainability, Malaysians need to ensure that they have the 2/3 income replacement ratio. The assumption behind the 2/3 replacement income ratio is that there will be a 50% reduction in all your work related expenses, while retirement expenses such as leisure, travel and healthcare will increase by 20%.

Based on PPA's calculation, in order to achieve the 2/3 replacement income, Malaysians should side aside 1/3 of their current monthly salary when they start their career. For someone who is already in the mid-career stage, more needs to be set aside. While 1/3 or 33% of monthly salary may seem like a lot, most Malaysians would already have set aside at least 23% contribution in EPF (Statutory minimum: 12% employer's contribution, 11% employee's contribution). As such, to meet the 1/3 or 33% requirement, one needs to allocate another 10% in a saving and investment scheme that provides return that beats inflation without taking too much investment risk.

HOW TO PLAN FOR YOUR RETIREMENT?

SAVE – Accumulating funds for retirement needs to be a disciplined and regular activity to accumulate the desired retirement nest egg. Smart retirement planning suggests that we set aside an additional 10% of our take-home pay for retirement. We also need to be very clear on the purpose-that it is for retirement only and not for other purpose. At PPA, we strongly encourage members to make regular monthly contributions in a PRS to inculcate the habit of saving for retirement, whether they are starting young in their 20s or later in their 50s. The longer the time horizon in saving for your retirement, the more savings you will attain to replace your income at retirement. Regular contributions will help to "dollar cost average" your savings, a technique designed to reduce market risk through systematic regular contributions at pre-determined intervals and set amounts.

INVEST – While saving is setting aside money, investing it provides compounding growth. Money that is saved and invested has the potential to enjoy compound growth and potentially higher return than money parked in bank deposits, to at least beat inflation. When investing, people need to ask what their retirement objective is – for pre-retirement accumulation capital growth or retirement income generation. In addition, people will need to customize their retirement investment plan according to their age, lifestyle and financial circumstances. Before making an investment decision, you should consider the different types of risks that may affect you and learn to manage risks by way of diversification, managing the performance of your investment and knowing the choices that are available to you.

RETIRE – Retirement is not a destination but a long journey. The 30 to 35 years' pre-retirement phase is a crucial time for a person to accumulate adequate funds for retirement. But it does not stop there. Retirement also means that during the golden years (also known as de-cumulation phase), one is able to manage one's retirement savings in order to stretch a good 20 years. To best way to do so is to keep your savings invested as passive income and make monthly withdrawal of a set amount, enough for your use as expenditure. This is to ensure that your money continues to work hard for you and for you to spend only on necessary things post-retirement.

ENJOY – Retirement should be the most exciting phase in our life but it requires having the income and financial security to make our retirement years golden ones. The end objective of retirement planning is to ensure that we enjoy our golden years with adequate, sustainable and inflation adjusted income.

The accumulating years, during which we seem to be sacrificing our immediate consumption for our future consumption, are the only sure way to provide enjoyment for our retirement years. Malaysians can now take control of their retirement by following PPA's simple formula for successful retirement – S.I.R.E (Save. Invest. Retire. Enjoy). ■