RETIREMENT PLANNING

SAVE NOW SO YOU CAN PLAY GOLF AFTER 60

Increasingly in future the onus will be on individuals to save for retirement as governments and employers contribute less. Here are answers to seven questions pertaining to one of life's most important financial goals

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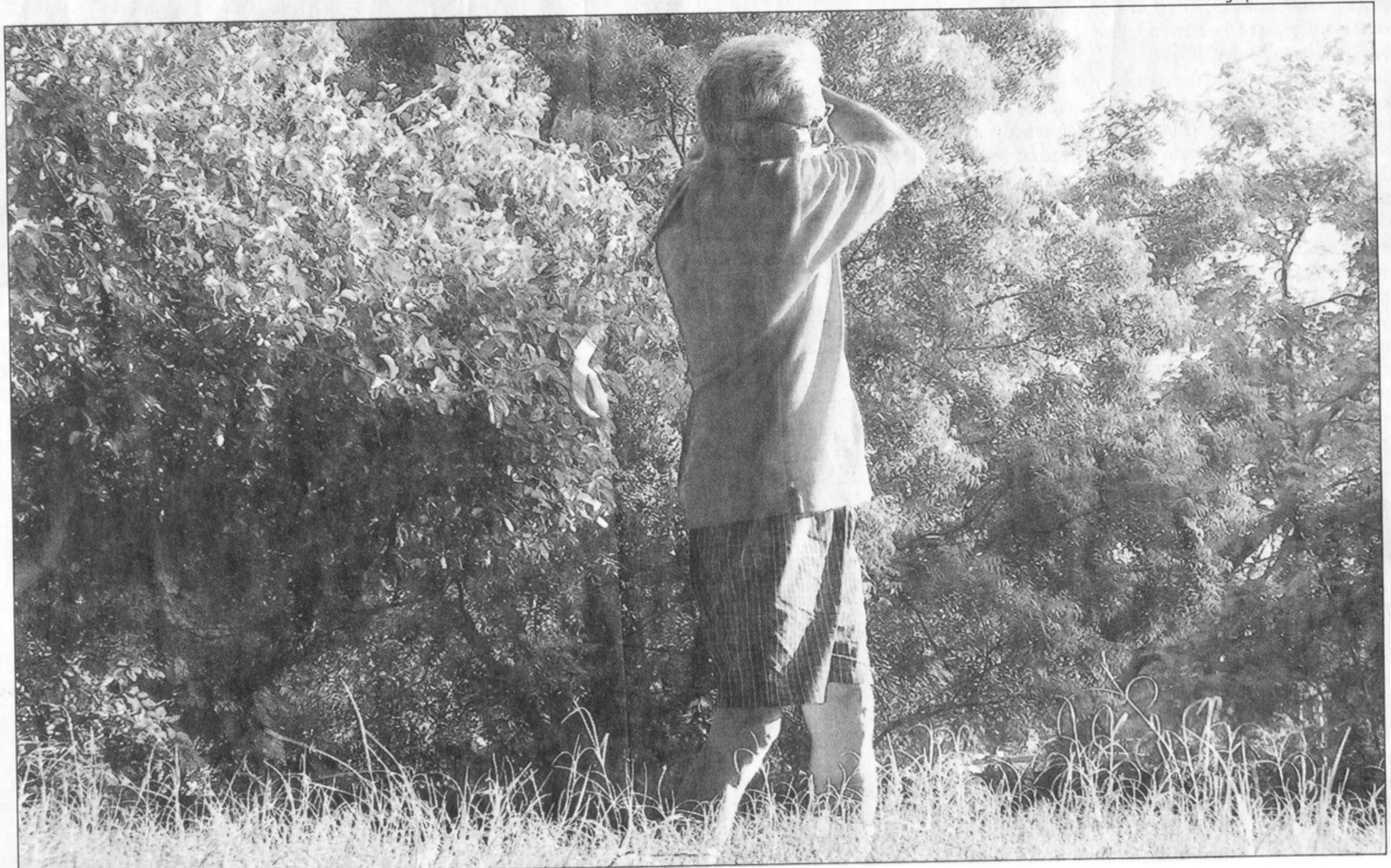

formance, and jettison those whose performance flags.

In the fixed-income part of the portfolio, Dhawan first suggests guaranteed return products, such as bank fixed deposits and PPF. "PPF is a good instrument, especially for investors who don't have an EPF. The 8 per cent post-tax return is higher than what you would get elsewhere. Its drawback is that you can invest only a limited amount, Rs 70,000, each year," he says. The rest of your fixed-income portfolio, he suggests, should consist of long-term income funds or long-term gilt funds held over many interest-rate cycles.

Remember that once the new direct tax code comes in, a lot of what has been suggested above could change.

Should you use the NPS?

First, let us dwell on its positives. If you invest the equity component of your retirement savings in the New Pension Scheme (NPS), it would get managed at a low cost. Its cost is lower even than that of an index fund. For young investors, especially, the low cost would make a substantial difference to the final corpus. Its second advantage is that since it offers limited liquidity, the money remains available till retirement and doesn't get used up for other purposes.

However, at present there are a couple of issues with the NPS. The most important is its tax status, which

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ACCORDING to the recently published HSBC Holdings PLC's *The future of retirement* survey, the ongoing economic downturn has wreaked havoc on the retirement plans of people in the developed world as equity and real estate holdings have shrunk in value. A lot of the people surveyed said they have postponed their retirement plans. But one positive outcome of the downturn is that conspicuous consumption is out and the age-old virtue of thrift is once again in. In India, though we have an annual savings rate of above 30 per cent, it doesn't necessarily translate into a large retirement corpus as people tend to spend a large portion of their savings on children's wedding and education and on setting them up in their careers.

When should you begin?

The earlier you begin the better. But the answer also depends on your circumstances. If you already own a house (say, ancestral), start saving for retirement as soon as you get your first salary. But if you don't own one, then first collect the money required for making the down payment on the house and then begin saving for retirement. Even if the amount you save at the beginning of your career is small, nonetheless make a start and let the power of compounding work its magic.

How much each month?

Try to save at least 25 per cent of your take-home salary. If you save less, it will be difficult for you to cater to your retirement needs and to the education needs of your children. How much you save should also depend on whether you are an employee and have forced savings in the form of Employee Provident Form (EPF), or a businessman who does not have such savings.

When should you save more?

From the time you get a job till you get married, you can save a lot. Then once you get married (setting up a new house takes a lot of money) and the children are born, savings decline. A few years after their birth, things stabilise. As you get into the mid- and late-thirties, you move up the career ladder, your salary grows, and you can save at a steady pace. Next, you have to dip into your savings in a big way when your children go for higher education and at the time of their wedding. Once the children are not dependent on you, your savings pick up once again till you retire.

On three important occasions, avoid the tendency to splurge and thereby deplete your retirement corpus. The first is when you are buying a house. "The first house is not really a part of your investment portfolio because it is difficult to monetise it. Whenever people are buying a house, there is a tendency to overstretch. That should be avoided. The same holds true while renovating the house," says Vishal Dhawan, a Mumbai-based financial planner.

Two, over-expenditure also happens at the time of children's wedding and while trying to fund their education. And finally, once the responsibilities towards the children are taken care of, long-suppressed yearnings, such as a world trip, begin to find expression. Again, such tendencies towards extravagance should be kept within bounds.

How much risk is just right?

This is a function of when you begin to save for retirement. If you begin early, the risk assumed is over such a long time period that there is little danger of loss of capital. It is only the volatility of equities that you have to tide over. On the other hand, if you start saving when you are 50 and will need the money when you are 60, there isn't enough time for equities to blossom. Taking too much risk at this stage would be foolhardy as you could end up losing your capital.

As for how much you should invest in equities, 100 less your age is the formula to adopt. This may be adjusted further to take into account your risk appetite.

What it takes to retire securely

S. P. Rawal, who along with his son currently runs a financial planning and advisory firm, Open Futures, in New Delhi, retired in 2000 as vice president of a firm called Gestetner. In 1990, 10 years prior to retirement, Rawal had invested in a pension plan from LIC. "I should have done so much earlier," he says. In addition, he also received a hefty Provident Fund corpus. These, along with the income from his business, allow him to concentrate on his golf handicap instead of having to worry about monetary issues. His advice to the young: "Start planning for retirement early." He also advises them to buy life and health insurance in addition to saving through mutual funds, real estate and fixed deposits.

Which are the right products?

The biggest issue that you have to tackle when saving for retirement is inflation. (Assume an average inflation rate of 7 per cent for calculating your future needs.) One instrument that helps you fight inflation is equities. Pune-based financial planner Veer Sardesai prefers to use index funds for the equity part of the portfolio.

Another investment you must make, as mentioned earlier, is in a house of your own. This asset class also combats inflation effectively. Once you retire, you won't have to pay rent, and the house can be liquidated in case of dire need. Alternatively, if your house is situated in a city, you could sell it and move to a smaller town or to your native village where a house would cost much less. People also move from bigger houses to smaller ones once the children have moved out. The money you earn from these transactions could go into your retirement kitty.

Broadly, Sardesai suggests a portfolio comprising equities, Employee Provident Fund (EPF), Public Provident Fund (PPF), gold (about 8 to 10 per cent of the portfolio), and a house. "For clients who are extremely risk-averse and don't want to invest in equities, we suggest long-term bond funds that should be held for a very long time period across several interest-rate cycles," he suggests.

Dhawan too suggests a mix of equities and fixed-income instruments. For the equity portion, he suggests both index funds and actively-managed funds. "In India many actively-managed funds manage to outperform index funds, though the degree of out-performance has been decreasing over the years," he says. In case you invest in active funds, select the right ones, monitor their performance … is EET. The NPS corpus gets taxed at withdrawal (while PPF and equity funds are not). Says Dhawan: "With the new tax code coming in, all instruments will be treated in a similar manner. Sooner rather than later, NPS will receive equal treatment. The reason why the NPS has been given EET status and not EEE status is probably that the government wants most products to move to EET status. Investors should wait till 2010-11 to see what the new tax code holds for NPS."

Another issue with the NPS is that at present it is difficult to decide which manager you should invest with as no historical data is available. On the equity side, the NPS at present works like an index product with no active management. If, for reasons mentioned earlier, you believe that actively managed funds should be a part of your portfolio, then this is not the product for you.

What should you avoid?

Finally, here are a couple of things to avoid when saving for retirement. Don't invest in products that are branded as retirement products. They are not better (in terms of returns or cost) than plain-vanilla savings products. Moreover, the mix of products you should invest in for retirement should depend on your risk-taking ability and how much risk you need to take in future to reach your goals. These branded products may not be right for your needs. Second, in case of many pension plans it is compulsory to buy an annuity at the end of the accumulation period. This is not a good idea. What if you don't need an annuity? So invest only in products that allow you the flexibility to invest your accumulated corpus wherever you wish to. ◆

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