RETIREMENT PLANNING

Are you saving enough?

ASHISH SHANKAR

A lot of us underestimate the corpus that we will need to fund our expenses during those 20 years or more that we are likely to live after retirement. Our columnist suggests a systematic approach to estimating that figure

VISHAL DHAWAN

AS WE exchanged cards and pleasantries before the start of our first financial-planning meeting, Rohit and Priya looked very keen to go ahead with the discussion on the goals that they were trying to save towards. As a standard operating procedure, they had already filled in the fact-finding form and had sent it in prior to the meeting, for me to go through and be prepared for the first meeting. While they had similar aspirations to other double-income couples their age — buying a larger home, annual foreign holidays and overseas education for their children — the one aspect of their financial plan that they did not want to plan for was their retirement. Since I found this rather strange, I decided to quiz them further.

"Rohit and Priya," I asked, "considering that you are still 15-20 years away from retirement, I do not see any goal of saving towards retirement in your sheet. Don't you believe it's time to start saving towards retirement?"

"Of course it is. However, we have already got our retirement plan in place," they replied in unison.

"That's impressive," I said.

Between the age of 35-40, most individuals we know are only in the process of starting to build their retirement corpus, after having provided for their primary residence. For salaried individuals, the provident fund is an automatic investment tool and helps partially towards taking care of their retirement needs. However, since both Rohit and Priya are first-generation professionals — Rohit is a cardiologist and Priya an interior designer — I was very keen to understand how they had achieved this. Most professional we know tend to start saving towards retirement as a last priority, after their other goals have been taken care of. While we always recommend to our clients that they should start saving for retirement as early as possible to get the benefit of compounding, since retirement always seems to be the farthest goal, it tends to come low down on the priority list.

"So tell me, how have you gone about planning for your retirement?" I asked.

Rohit was first off the block. "My retirement planning started very early on, about 15 years ago, when I purchased a pension policy. An insurance agent had visited my clinic and told me about the tax benefits of investing in a pension plan. Since the maximum tax deduction I could get at that stage was Rs 10,000, I contribute a sum of Rs 10,000 per annum towards my pension plan. I understand this limit has been revised upwards a few years ago, but I continue to contribute Rs 10,000 to the pension plan."

"Is that all? And how much do you expect to get at the end of this period?" I asked.

"Well, I have been saving through my pension plan for 15 years already and plan to do so for the next 20 years as well. I am not sure about the exact amount I will get. I have a document at home that states the exact amount, but from what I remember it's a pretty handsome sum," Rohit said with a satisfied smile on his face.

"Priya, could you tell me how you are planning for retirement? I asked.

"I put away a sum of Rs 3,000 per month in my PPF account, which gives me a tax benefit and also allows me to get a tax-free corpus after 15 years, which I can use for retirement."

"Anything else that you'll do?" I asked.

"That's it," both of them replied in unison.

A systematic approach

"It's a good thing that both of you are actually saving towards retirement. But the moot question is whether this is enough. Your current personal expenses are about Rs 75,000 per month. Assuming that your expenses continue at similar levels post retirement as lifestyle changes will continue to take place, an inflation rate of 8 per cent per annum would cause your expenses to increase nearly five-fold to Rs 3.5 lakh per month. Your corpus from the pension plan and PPF accounts put together at current contribution rates will be in the region of Rs 35 to 40 lakh, enough for just one year of retirement expenses," I replied.

"We never looked at it that way," they said. "So how should we go about calculating how much to save?"

"You will need to go through a structured process to plan for retirement," I said. I then went on to outline the steps:

Step 1: Make a list of your current expenses.
Step 2: Critically evaluate each expense head to see whether it is likely to increase or decrease post retirement.
Step 3: Apply an appropriate inflation rate to each expense head to arrive at the likely expense at retirement age.
Step 4: Estimate the corpus that you will require to meet these inflated expenses for the period from your retirement till your death.
Step 5: Evaluate the amount you need to save each month or year to achieve the desired corpus.
Step 6: Monitor the plan annually.

"That appears to be a more systematic approach," they exclaimed. "So what should we do next?"

"Time to put our heads down and do some number crunching," I replied, "and then just ensure that we stay on course with the plan." ♦

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