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The NPS change that will have a big impact on retirement planning

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The most significant advantage of this enhancement in equities is that historically equities have been known to beat inflation over long periods. Photo: iStock

The biggest challenge for individuals retiring in our country has been the lack of a social security system to provide a meaningful family pension income post retirement. Unfortunately, this challenge may still take time to get addressed. The second biggest challenge for savings towards retirement has been creating portfolios that beat inflation. Inflation is to retirement portfolios and financial health, what high blood pressure or diabetes are to physical health, a silent killer. Luckily there is help on hand to deal with this, especially with the changes introduced in the **National Pension System** (NPS), the targeted savings solution that still struggles to get enough attention for individuals planning for retirement.

While there have been multiple changes in the NPS over the years, one of the recent changes made in the NPS, which allows higher equity exposure, has a very significant impact on retirement planning. Essentially, this change in feature in the NPS has made it even more attractive for **NPS investors**. The NPS now allows multiple variations with higher equity exposure whilst planning for retirement, making it far more capable of beating inflation challenges in your retirement portfolio. Whilst **investing in NPS**, investors have always had the choice of choosing from two options: active and lifecycle.

For NPS investors choosing the active option, the investor can choose his asset mix amongst four asset classes as per his choice – Equities (E), Corporate debt (C), government securities (G) and alternative investment funds (A). Prior to this change, the exposure to E was capped at 50% of the portfolio. With the recent changes, the maximum permitted allocation to E has now been enhanced to 75% up to 50 years of age. From 51 years onwards, the maximum equity allocation allowed will keep reducing by 2.5% per annum, and become a maximum 50% at the age of 60.

For NPS investors who prefer using the auto choice option, as they may not believe they are skilled enough to make decisions across the four asset classes ie E, C, G and A, the investor can use a lifecycle fund which also has three variants – LC 75, LC 50 and LC 25.

In the case of the LC 75 – Aggressive Lifecycle Fund the fund has a maximum of 75% in equities up to 35 years of age, and then drops gradually to 15% at age 55 and above. In the case of the LC 50 – Moderate Lifecycle Fund, the fund has a maximum of 50% in equities up to 35 years of age, and then drops gradually to 10% at age 55 and above. In the case of LC 25 – Conservative lifecycle Fund, the fund has a maximum of 25% in equities up to 35 years of age, and then drops gradually to 5% at age 55 and above.

The most significant advantage of this enhancement in equities is that historically equities have been known to beat inflation over long periods. In fact the **Employee Provident Fund** (EPF) that most investors are familiar with, has also enhanced equity exposure due to the ability of equities to beat inflation over long periods. For investors who have at least 10 years towards retirement, they should be allocating a meaningful portion of their portfolio to equities, especially since the entire corpus will not be needed at the start of retirement. It is critical that the NPS strategy is aligned with the rest of the portfolio strategy so that investors are able to take a holistic approach with respect to their retirement. For example if investors are already having a very aggressive investment strategy for their non-NPS retirement funds, they may need to accordingly adjust their NPS strategy so that the overall retirement strategy results in an asset allocation they are comfortable with. Similarly if most of the existing allocations to their retirement strategy is in fixed income oriented strategies, they may wish to use a more aggressive **NPS strategy** to balance the overall asset allocation.

Don’t neglect the silent killer of your retirement portfolio, manage it carefully.

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