

7 GOLDEN RULES OF RETIREMENT

Experts contend that retirement planning should start from the day you start earning. Sound advice indeed, but one that is seldom followed. So ET Wealth decided to bring to you seven rules of retirement planning that have been advocated by experts for decades. Follow them and you can be sure to retire in comfort

1. Save 10% of your income for retirement

The first rule of retirement planning is also the easiest to follow. If you have a regular job, then 12% of your basic salary and an equal contribution by your employer that flows into your Provident Fund account is a good way to build a nest egg. The best thing about this option is that you cannot avoid it. EPF rules require all employees to contribute 12% of their basic income to retiral savings, which include the Employee Provident Fund and the Family Pension Fund. It is a forced saving that becomes the default retirement plan for many individuals.

The amount of contribution to the EPF does not matter. Given the power of compounding, even a small contribution can bloat into a big sum over the long term. Don't underestimate the significance of the savings in the first few years. Assuming that a 25-year-old investor

puts away a fixed amount every month, his savings in the first five years will account for 44% of his total corpus when he is 60 years old. The later you start, the more you will need to save. If you have started late, say in your 40s or 50s, you will have to invest up to 20-25% of your income if you want a comfortable retirement.

The 10% rule is crucial for self-employed professionals and others who are not covered by the EPF umbrella. They can opt for mutual funds, choosing the ones that suit their risk appetite and age profile. However, you need to have the discipline to put away the given sum on a regular basis.

SMART TIP: Start an SIP in a mutual fund and automate the process by giving an ECS mandate to your bank. In this way, your retirement planning will stay on track.

2. Increase investment as your income grows

According to recruitment firm ABC Consultants, India Inc hiked salaries by 12-15% in 2011. By how much did your income go up? More importantly, did you step up the quantum of your investments accordingly? Not many people do that. Sure, inflation has been on the rise and most of this year's increment would have been nullified by the increase in the cost of living. But even when there is a marked increase in the investible surplus, people don't match their investments with the increase in income.

This is understandable since it is human nature to put things off, especially ones that require sacrifices in return for future rewards. This can severely undermine your retirement planning. If a 30-year-old with a monthly salary of ₹50,000 starts saving 10% (₹5,000) for his retirement every month in an option that earns 9% per year, he would have accumulated ₹92

lakh by the time he is 60. Now, assuming his salary increases by 10% every year and he raises his investment accordingly, he would have a gargantuan retirement corpus of ₹2.76 crore. If he does wait five years to raise it by 50%, he will have ₹1.93 crore.

It is important to maintain the retirement savings rate at 10% so that your nest egg doesn't fall short of your requirements. The icing on the cake can be periodic boosters whenever you get a windfall, such as a tax refund or a lump-sum payment in the form of, say, an annual bonus. The trick is to commit yourself to save more in the future.

SMART TIP: Whenever you get a raise, allocate half of it to savings. You might not notice the change since you will be enjoying the other half of the raise.

3. Don't dip into corpus before you retire

This might sound weird, but every time you change jobs, your retirement planning is at a grave risk. This is because you have the option to withdraw your PF balance at that time or transfer it to the account with the new employer. Besides, there is the option to withdraw your PF amount if you need the money for specific purposes, including your child's marriage, buying or building a house, or in medical emergencies. Dipping into the corpus before you retire prevents your money from gaining the power of compounding. Don't underestimate what this can do to your retirement savings over the long term. A person with a basic salary of ₹25,000 a month at the age of 25 can accumulate ₹1.65 crore in the PF over a period of 35 years. This is based on the assumption that his income will rise by 10% every year.

Yet, many people are unable to reach the ₹1 crore milestone in their PF accounts. Although the paperwork is minimal, a lot of people prefer to withdraw their PF money when they change jobs or for other purposes. This, despite the fact that the government discourages you from withdrawing the money. The withdrawals from the EPF within five years of joining are taxable.

The sudden flush of liquidity can trigger a spending spree and ill-planned decisions that can cripple your financial planning. Often, the money goes into discretionary spending, which means your retirement planning is back at square one. A late start means a smaller corpus even if you start investing more.

SMART TIP: Instead of withdrawing your EPF balance when you change jobs, transfer it to the new account by filling 'Form 13' and submitting it to the new employer. This should be at the top in your list of priorities at the new workplace.

4. Withdraw 5% a year initially, then step up

One of the biggest challenges for tomorrow's retirees is to ensure that they don't outlive their savings. This is a distinct possibility because of two major factors: rising cost of living and an increase in life expectancy. High inflation, in fact, is enemy no. 1 for the retired investor. Sure, the inflation rate will not remain as high as it is right now. However, over 20 years, even a nominal inflation of 6% will reduce the value of ₹1 crore to ₹29 lakh. Besides, Indians are living longer. Life expectancy rose from 61.3 years in 2000 to 66.46 years in 2010. By 2020, the average Indian can expect to live till 72 years. In urban areas, where people have better access to healthcare, and in higher income groups, the life expectancy could extend beyond 80 years.

To ensure that you don't run out of money in your old age, you must have a drawdown plan in place. The thumb rule is not to withdraw more than 5% of the corpus in the first five years of retirement. This can be progressively increased to 10% by the time the retiree is 70. This essentially means that the retiree should draw down less than the appreciation in the initial decade, but in the next 10 years, he can withdraw more than the accretion to the corpus. At 80, even a 20% annual drawdown rate would be considered safe.

The problem arises because most Indians are not comfortable with the idea of drawing down from their corpus. There is an overarching desire to leave something behind for their heirs and dependents. Given the inability of a corpus to beat inflation in the long run, the retirees should be prepared for a depletion of their corpus.

SMART TIP: You can safely draw down half the inflation-adjusted appreciation every year. If the portfolio has earned 12%, you can easily withdraw 6%.



5. 100 – age = Your allocation to stocks

An investment portfolio's performance is determined more by its asset allocation than by the returns from individual investments or market timing. How much you have when you attend your last day at work will depend on how you divided your retirement savings between stocks, fixed income and other asset classes. Experts recommend that you should have an equity exposure of 100 minus your age. So, at 30, you should have about 70% of your portfolio in equities. At 55, the exposure to this volatile asset class should have been pared down to 45%. After you retire, your exposure to stocks should not be more than 25-30% of your portfolio.

Even within equities, the type of stocks

(or equity funds) in your portfolio should vary with age.

This is not a hard and fast rule and should also take into account the financial situation of the individual. It assumes that all people at a certain age will have the same risk appetite. This is not true. A 45-year-old person with a good income and few dependants will be able to take on more risk than someone who is 30 but has a low and unsteady income.

SMART TIP: Invest in asset allocation funds that redistribute the corpus depending on the age of the investor. As he grows older, the exposure to equity is progressively reduced.

6. Borrow for education, save for retirement

Indian parents love to save for their children. Whether it is for their education or marriage, or even to provide them with a comfortable life, children are the biggest motivators of savings in the country. But before you pour money into a child plan, make sure your retirement savings target has been met. In an effort to fulfil the needs of the child, Indian parents sometimes sacrifice more than they should. Some even dip into their retirement funds to pay for the child's education. This is risky because your retirement is going to be very different from that of the previous generations. It will be entirely funded by you and won't have the cushion of defined benefits.

This doesn't mean you should compromise on your child's education. It can still be done through an education loan. In the past two decades, we have seen how the MRP of a product has been replaced by its EMI in our everyday lives. Home, travel, car, education, gold,

consumer durables—you can get a loan for almost anything and everything. What's more, the government encourages you to take loans by offering tax breaks on the interest paid on housing and education loans. No bank, however, is going to lend you for your retirement. Sure, there are reverse mortgage schemes, but those require your house to be kept as collateral.

Under Section 80E, income tax deduction is available only if the education loan has been taken for yourself, your spouse or children. Also, the loan should be from a bank or a financial institution notified for the purpose. No tax deduction is available if the loan has been taken from a private source.

SMART TIP: An education loan helps inculcate financial discipline in the child. If he is responsible for the repayment, he gets into the saving habit early in life.

7. Save 20 times your annual expenses

This rule is different from others because it is based on how much you spend, not on how much your investments earn. Knowing your post-retirement expenses is crucial to retirement planning. Some expenses, such as those on clothing and entertainment, come down. Others, such as transportation, medicine and insurance, go up. Add up all the expenses you are likely to incur after retirement to know how much you will need per month. Then, multiply this amount by 240 to know how much should be your retirement corpus.

However, this calculation is based on a number of assumptions. Firstly, you should not have outstanding loans when you hang up your boots. Secondly, you and your spouse should have sufficient health insurance. A

survey conducted by HSBC earlier this year shows that unforeseen expenses and medical costs are the biggest concerns for Indians during retirement.

The good news is that Indians are increasingly becoming aware of the need to plan their retirement. In a 2010 survey by Bharti Axa Life Insurance in eight top cities in the country, 74% of the respondents said that they knew how much they would need after retirement. Three years earlier, only 53% had a fix on how much they would require in their sunset years.

SMART TIP: Buy a health insurance cover that continues till you are 70-75 years old. It is difficult to buy one afresh when you are older and not so healthy.