# Importance of Retirement Planning: Financial Education for Retirees

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ASK ANYONE ABOUT THE IMPORTANCE OF PLANNING FOR HIS OR HER 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 SECURED RETIREMENT. THERE IS A RELUCTANCE TO PLAN FOR THE FUTURE, AS RETIREMENT OFTEN SEEMS TO BE FAR AWAY, 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," and 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 on how people plan for their retirement. This, together with a lack of urgency, often leads them to procrastinate in taking action now to secure their retirement plans.

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## THE 5 RETIREMENT MYTHS

**Myth#1** – Malaysians have the mindset that their 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 earned income. EPF 2011 statistics showed that a whopping 72 per cent of EPF members who are at the pre-retirement age of 54 have savings of just RM50,000 and less. Coupled with that, 50 per cent of retirees spend their entire EPF savings within five years.

**Myth #2** – 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 families, much less than for their own old folks.

**Myth #3** – There's plenty of time. It all has to do with timing. Some people reckon it is too early for them to start saving for retirement, while others think they can't do much because it is already too late for them to start. 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. This deals with working after retirement. Choosing to work after retirement is one thing, but being compelled to work just to survive is another.

**Finally, Myth #5** – 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 an environment with rising inflation and increasing medical cost. It is imperative to plan your finances adequately for your retirement.

## THE BIG RETIREMENT PROBLEM

Research has shown that the reason 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 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 render 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 that more than half of retirees in Malaysia spend their entire EPF savings within five years. It is easy to fall into the trap of depleting your retirement savings if one treats the savings as a windfall and not keeping it invested to garner passive income.

Whilst the above retirement issues have been commonly raised, the lack of interest and urgency for people to take planning for their retirement seriously suggests that there is a need to bring 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 three main issues that must be addressed now; otherwise they may contribute towards making retirement a big problem later.

First, 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 standards of living. The rule of thumb is 2/3 replacement income ratio of the last drawn salary, i.e. if a person earns RM6,000 before he retires, he will need RM4,000 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 retired, retirees will have to cut back on their living standards or fall into the dependency of others to take care of them, especially if they are no longer fit to work to earn their own income.

Second, people need to ensure that their income can sustain them for the whole duration of their retirement years. The key issue here is outliving your retirement funds, which would otherwise leave people very vulnerable and out of income to support when they are older. Malaysians are living longer and longer. The current average life expectancy of a Malaysian 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, Malaysians on average 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, with the current retirement age at 60.

**THE CURRENT AVERAGE LIFE EXPECTANCY OF A MALAYSIAN**

75

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**Leaving one’s retirement to chance may put you in financial jeopardy, resulting in old age dependency and poverty.**

Finally, there is a need to have retirement income inflation adjusted. Inflation has a subtle and quiet way of increasing the cost of living and eroding purchasing power. While RM1 million seems a lot today, it may not buy a lot 10 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, sustainability and inflationary are not addressed now with proper planning for retirement, people will be leaving it to “chance that things will turn out alright” for them when they retire. Leaving one’s retirement to chance may put you 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 periods of savings and longer periods 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 and the voluntary PRS scheme. In the future, every working Malaysian ought to have two retirement schemes that will provide financial security for their retirement.

## HOW TO PLAN FOR YOUR RETIREMENT?

**Save –** Accumulating funds for retirement needs to be a disciplined and regular activity to achieve the desired retirement nest egg. Smart retirement planning suggests that we set aside an additional 10 per cent of our take-home pay for retirement. We

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also need to be very clear on the purpose, that it is for retirement only and not for other purposes. At PPA, we strongly encourage members to do regular monthly contributions for PRS to inculcate the habit of saving for retirement, whether you are starting young in your 20s or later in your 50s. The longer the time horizon one saves for your retirement, the more savings one 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 the 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 a 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, people should consider the different type of risks that may affect them and learn to manage risks by way of diversification, managing the performance of investments and knowing the choices that are available.

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

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

For all the accumulating years, which seem to mean sacrificing our immediate for our future consumption, it is 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).