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Your New Retirement

As you grapple with the daily grind that life is, there is a real danger that you may not be planning well enough for the golden years. A few tips

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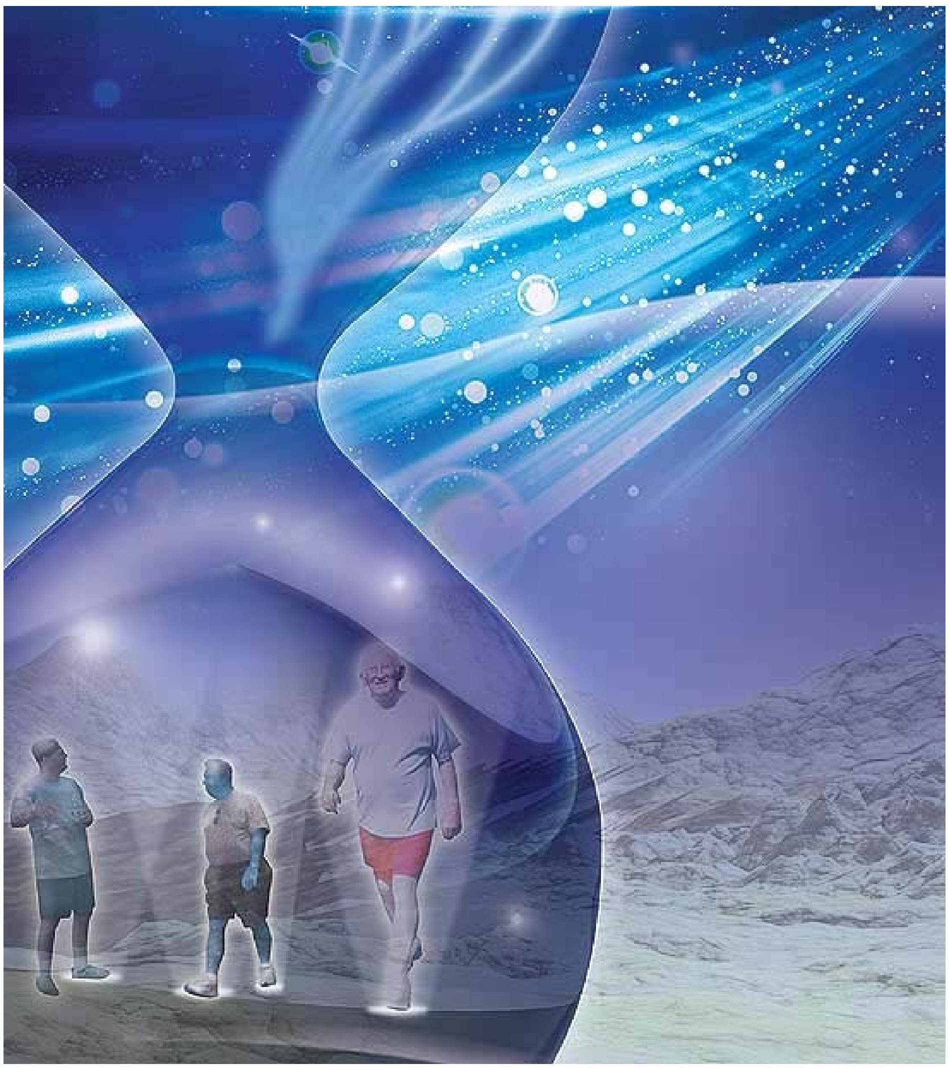

The Change Agents

- **Longer retirement** The average life expectancy of an urban Indian working in the organised sector is expected to hit 80 years or more by 2015, calling for an early start to retirement investing.
- **Demographics** In the next 10 years, over 76 million Indians will be senior citizens, going up from 51 million in 2005.

- **Greater Investment** More investment risks due to volatile markets and fluctuating interest rates means vulnerability of retirement investments to these risks. Inflation also a concern.
- **Regulations** Mandatory retirement schemes, where contributions are fixed, but not benefits, make of these accumulations susceptible to market conditions.

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What's On The Horizon

- **Large Retirement Corpus** To see through more than two decades of retired life, you will need much more money than previous generations did.
- **Deferring of Retirement** Many people falling short on their retirement accumulations will be forced to extend their work life even if at a lower pay.
- **Second, third and fourth careers** Improving health and healthcare standards will help people remain active for much longer and extend their work life. Highly skilled individuals will typically embark on one or two new careers after the culmination of their first career.
- **Retirement Housing** Senior citizens will increasingly consider retirement communities which will have gated housing with adequate security, high quality amenities and customised support available.
- **New Annuity Products** Fixed, variable and inflation-indexed annuity products will become available.
- **Reverse Mortgage** Long retired lives, along with inflation, will leave many retired people short on funds, especially towards their late retirement years. Home owners will use reverse mortgage to bridge the gap.

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Winner Moves

- **Self-Help** Self-directed retirement investments will bolster the sum accumulated from mandatory retirement savings vehicles. Start early.
- **Equity Exposure** For retirement investments, this is the best way to beat inflation in the accumulation period. Slowly cut equity exposure as you near retirement.
- **Equity In Portfolios** Some equity exposure even in retirement is needed to beat the impact of inflation.
- **Health Cover** required to protect against healthcare costs that rise faster than inflation.

Caught up the increasingly frenetic rat race, are you one of the many Indians who secretly dream of a time in life when you would get to do what you cherish? We are talking about things like getting a good night's sleep without feeling guilty that it will leave you with less time to prepare for the presentation, or playing golf with friends, not just on weekends, but whenever you wish to, and so on. There are many who think that they will be able to do so when they are out of the race, i.e., when they retire. Will these ambitions materialise? The key lies in understanding the interplaying change agents that are creating the New Retirement, one that is very different from the retirement that we know.

The Change Agents

Changing demographics. The average life expectancy of an urban Indian working in the organised sector was estimated at 75 years in a report submitted in 2000 by the OASIS committee, a panel that worked on the blueprint for Indian pension reforms. The panel also estimated that the female spouse typically lived five years more than the male spouse. No wonder, HelpAge India, a non-profit charity organisation working to protect the rights of the elderly, expects a large increase in the 80-plus population in India in the years to come. The number of 60-plus Indians is likely to touch 76 million in 2020, up from 51 million in 2005. This means there will be a significant number of Indians leading long retired lives of more than two decades.

Increasing risk of outliving money. Longer retired lives means that millions of Indians would suddenly face a potent financial risk unknown to their previous generation—the risk of outliving one's money. So far, this risk has impacted only the populations in the West and other developed countries. Ageing Indians will face some formidable disadvantages compared to their Western counterparts. To begin with, they can expect no basic old-age support from the government, even for healthcare, as is prevalent in the US. The savings that they make in mandatory retirement savings vehicles, such as provident funds, will never be able to beat inflation.

Changing regulations. In the past, pension systems the world over provided subscribers with predictable or defined benefits. You had an idea of how much you would get on retirement. Not anymore. The increasing burden of pension liabilities on governments and the private sector across the world, including India, has forced the migration to defined contribution schemes—while your regular contribution is governed by rules, what you get on retirement depends on the performance of the pension fund. The New Pension System (NPS), applicable to all government employees joining service on or after 1 January 2004, is a defined contribution scheme. From 1 May 2009, it was made it accessible to those outside the government sector as well.

Disintegration of traditional family structures. In the past, large joint families provided a financial cushion to members in distress. A decade ago, over 70 per cent of Indians lived in the joint family system. Today, the number is less than 40 per cent. Increasing migration and urbanisation have only hastened the process. This means people can no longer look to families or children for financial support in retirement.

Greater investment and inflation risks. Even if you take retirement planning in your own hands, it's an exercise not free from grave risks. You can do so by getting into self-directed investments in general investment products, such as stocks, equity funds and others, or in pension products, such as pension plans by life insurance companies and mutual funds, or the NPS. But, in that case, you will have to manage the great investment risks emanating from fluctuations in the stockmarket and interest rates. Also, the rising inflation would eat away the purchasing power of retirement funds.

"The minimum contribution to NPS may have to be raised. One may see the launch of inflation indexed annuities." **--Dhirendra Swarup, Former Chairman, Pension Fund Regulatory and Development Authority (PFRDA)**

"The elderly will form groups in existing cooperative societies and support groups among themselves." **--Mukul Asher, Professor of Public Policy, National University of Singapore**

"You could see fixed annuity products coming up and if the regulations permit, variable annuity products could come up in the near future." **--Rajiv**

"In the near future, pension assets may reach Rs 1,00,000 crore on greater participation in the NPS (New Pension System)" **--H.Sadhak, CEO, LIC Pension Fund**

Jamkhedkar CEO, AEGON Religare Life Insurance

"The rise in lifestyle diseases and costs can will wipe out retirement savings (of many families)" **--G.V. Nageswara Rao, MD & CEO, IDBI Fortis Life Insurance**

"Under the Direct Tax Code (DTC), NPS would be eventually be brought under the exempt-exempt-exempt (EEE) category" **--Balram Bhagat, CEO, UTI Retirement Solutions**

What’s on the horizon?

Required, a large retirement corpus. Suppose, as a 30-year-old, you plan to retire at 58 and hope to live till 65. In that case, you would require a retirement corpus of Rs 79.8 lakh (assuming monthly expenses at Rs 25,000 at an inflation rate of 6 per cent and return on investments at 8 per cent). Now, if you hope to live till 80, with other factors remaining the same, you would need a corpus of Rs 1.56 crore, an increase of 95 per cent. This means that either you have to save more, or have a higher rate of return on investments, or both. Going for returns higher than, say, 14-15 per cent per annum—which equities can give over 14-15 years—would mean taking unacceptable risks. Thus, a natural corollary is that you would have to start retirement investing early in your life.

Another reason for early retirement investing is the escalating healthcare costs as illnesses tend to strike more frequently as you age. This is more so as 70 per cent of the healthcare bill of an Indian is borne by himself. Only a miniscule 12 per cent of expenses is covered by health insurance due to its low penetration in India, estimated to be 2-2.5 per cent of the entire population. Surveys reveal that, on an average, a single episode of hospitalisation could cost a family close to 60 per cent of their annual income. Mukul Asher, professor of public policy, National University of Singapore, and a retirement expert, feels that in the coming years, it is probable that the single-most prominent reason for a household sliding into poverty would be a major episode of ill-health, particularly that of the main bread-earner.

The hike in the healthcare bill for the retired could also be attributed to an increase in lifestyle diseases, such as heart ailements and diabetes, that typically set in among populations with improved life expectancy. India already has the largest number of diabetics in the world with an estimated 51 million afflicted. Says G.V. Nageswara Rao, managing director and CEO, IDBI Fortis Life Insurance: “The rise in lifestyle diseases and costs has made it difficult for senior citizens to afford good healthcare and this can wipe out retirement savings.”

Deferring of retirement. Many people falling short on their retirement accumulations will be forced to extend their work life even if at a lower pay. Says Asher, “The current retirement age is no longer appropriate (given the trend of) the long life expectancy.” In most of the OECD countries (such as Austria, Denmark, Netherlands and Sweden) the retirement age is 65 years. In the US, it is 66, but likely to be increased further. According to Mercer Retirement Benefits Consulting, a leading global provider of consulting, outsourcing and investment services, this phenomenon will gain momentum. The retirement age in the Asia Pacific is expected to rise to anywhere between 60 and 65 by 2015. Changes are already being witnessed in India. Recently, a committee set up by the finance ministry recommended that the retirement age of public sector bank employees be raised from 60 to 62.

Embarking on second and third careers. Very soon, a mass-affluent urban Indian’s career will not end at the age of 58 or 60. The critical trigger would be the increasing need for people with domain expertise. Cautions E. Balaji, CEO, Mafoi Randstad, an international HR services firm:

“India is not a great place for a second career and it is not easy for those in the middle and lower levels of management to find jobs.” Richard Jackson, senior fellow, Centre for Strategic and International Studies, a public policy research institution, anticipates a skills gap as rapid globalisation leads to the need for higher skill levels. Those looking at a second and third careers might have to work towards developing better skills.

Retirement housing and communities. Senior citizens will increasingly consider retirement communities, which will have gated housing with adequate security, with high-quality amenities and customised support available. Retirement communities have peaked and declined abroad, but in India, they have just started gaining popularity. Housing for elders has already started mushrooming on the outskirts of cities such as Mumbai, Delhi, Bangalore, Kochi, Chennai and Pune.

Real estate companies are ensuring that community homes built by them meet all needs of the elderly. Facilities include special lifts, non-skid flooring, doctors on call, tie-ups with hospitals in the neighbourhood and convenience stores, including pharmacies. For instance, LIC Housing Finance (LICHFL), one of India’s prominent non-banking home finance companies, is ready to launch two retirement home projects in Bhubaneswar and Jaipur. The company is planning to launch one project in every state every year. In 2006, LICHFL launched a retirement project in Bangalore and units were sold for Rs 6 lakh-8 lakh. The rates for upcoming projects are not known but R.R.Nair, CEO, LICHFL, says “they will be reasonably priced”. You can find numerous such examples across India, be it in Jaipur, Pune or other cities. Life-time lease options are also available. Apartments can be leased for 15-20 years with a minimum lock-in period, which could range between one and two years. However, these retirement facilities will come at a price. A unit in a retirement community could range anywhere between Rs 20 lakh and Rs 80 lakh. Also, the builders look for a security deposit of Rs 2 lakh-5 lakh. But there could be other forms of retirement communities as well. “It is more likely that on a voluntary decentralised basis, the elderly will form groups in existing cooperative societies and make plans to form support groups among themselves,” says Asher.

New retirement products. Longer retired lives will spawn a whole range of retirement accumulation and retirement income products. The former class has seen growth in life insurance with pension plans from this industry raising Rs 7,258 crore last year, or 24 per cent of unit-linked business (individual). For retirement accumulation products, the expanding reach of NPS holds the key. Says Dhirendra Swarup, former chairman, Pension Fund Regulatory and Development Authority (PFRDA): “There would be an increase in subscribers if costs are kept low and returns high.”

So far, the absence of incentives to distributors has held back the subscription, with it having only 5,600 subscribers who are not mandated by law like the government employees. “NPS will provide a fillip to the corporate debt market since NPS guidelines allow 40 per cent of the funds to be invested there,” says Hira Sadhak, CEO, LIC Pension Fund. NPS, whose current availability is unsatisfactory, can also become attractive when bundled with a retirement health offering. Sadhak suggests that at the time of withdrawal from the NPS at the age 60, or at retirement, health insurance can be transferred to the respective insurance company. There are others who are banking on direct tax reforms embodied by the new Direct Tax Code (DTC) that the government seeks to implement soon to help the NPS. Balram Bhagat, CEO, UTI Retirement Solutions, says, “Under DTC, NPS is likely to be bought under the EEE (exempt-exempt-exempt) category, boosting its growth.”

The currently sleepy regular retirement income products will also witness action very soon. “There would be an increase in guaranteed pension products,” says Sadhak. “Fixed annuity products would come up in the near future along with variable annuity products, if regulations permit,” Says Rajiv Jamkhedkar, CEO, AEGON Religare Life Insurance. Variable annuity investments allow you to receive periodic payments in a tax-deferred manner, which means that you pay no taxes on the income until you withdraw your money. They also offer death benefit.

Several variable annuities abroad offer a guaranteed rate of return, even if the underlying investments perform poorly. This would be suitable for those who are uncomfortable investing in the highly volatile equity markets. However, the costs involved would be higher. People like Swarup also expect introduction of inflation-indexed annuities, where they are purchased with a single payment with a payment plan that starts immediately. The payments are indexed to the rate of inflation. Deena Katz, president of Miami-based investment firm Evensky & Katz and the US author of *Retirement Income Redesigned* warns that one should purchase such annuities "only from the very strongest companies and only from firms that do not take all of the potential benefit out in fees and commissions".

Increasing use of reverse mortgage. Long retired lives, along with inflation, will leave many short on funds, especially towards their late retirement years. As a result, asset (house)-rich elderly will be able to unlock the value of their house thanks to reverse mortgage. Under this product, the lending institution disburses money to you after valuing the house. You will not be required to repay the money during your lifetime. Launched in 2006, the concept is yet to take off big time. In the present day, most big public sector banks offer reverse mortgage as a product. Prominent players include State Bank of India, Punjab National Bank, Central Bank of India and so on. One of the major reasons why it didn't take off was that the money the lending institutions gave to the elderly was taxed. "This issue has already been clarified and now the money is tax-free in the hands of the elderly," says S. Sridhar, chairman and managing director, Central Bank of India and National Housing Bank.

With retirement funding requirements increasing, one can expect players to modify their offerings to the retired seeking them.