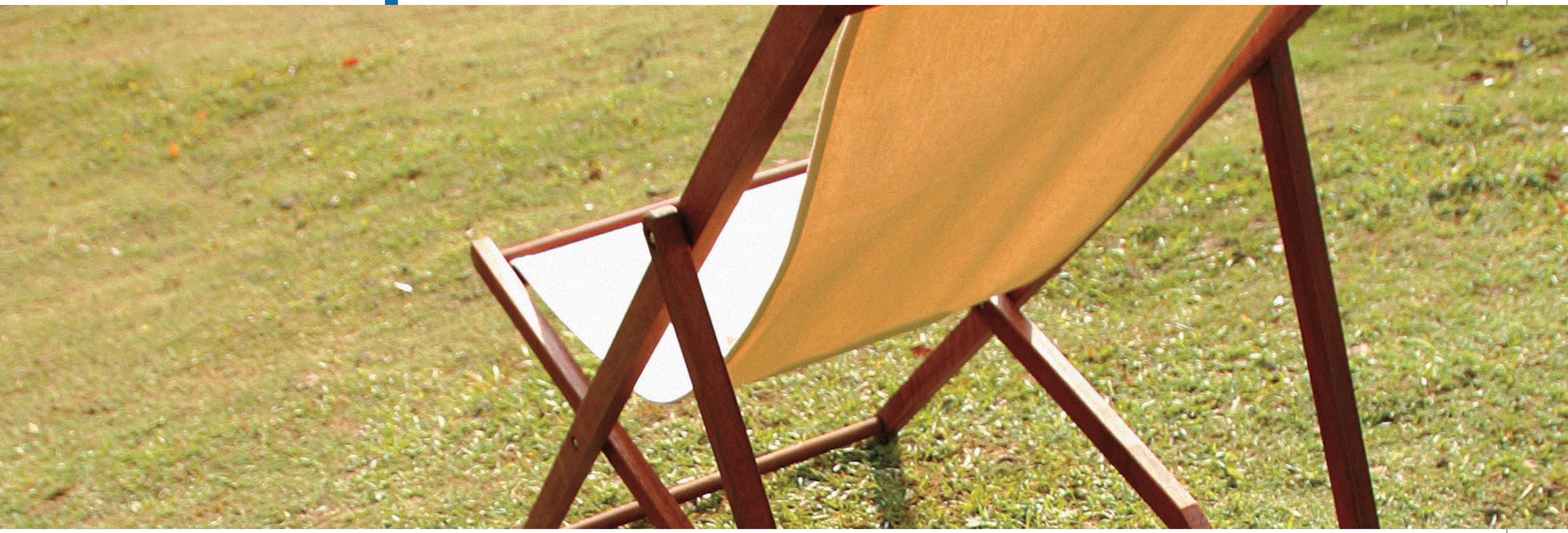

Planning for a Comfortable Retirement

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Financial Planning is not just about planning for wealthy clients or only investment planning; it's about helping our clients meet their life goals through the proper management of their finances and these clients could be from any strata of the society.

One of our clients, Mr. Rajkumar Agarwal, a lower middle class individual, wanted to manage his limited finances well, so that he could have a safe, secure and comfortable life. After talking to him, we noticed that he was concerned about his retirement and wanted to start saving for his retirement. His primary concern was that he was not aware of the amount he will get from his employer sponsored retirement benefit plans, when he retires at age 60.

As the conversation proceeded, and he became comfortable with us and he started sharing his personal and employment details with us. Mr. Agarwal, aged 36 years was employed with a public company M/S Witcom Ltd since last 7 years. His family consisted of his wife Aditi, son Ajay age 7 years and daughter Priti age 4 years. He expected to live till 80 years.

Mr. Agarwal currently drew basic annual salary of Rs 1.50 lakh along with other perquisite and sales incentive. He expected his salary to increase by 10% every financial year. His organization was covered under Gratuity Act and EPF Act with retirement age fixed at 60 years. We found that his employment rules restrict the liability of company's contribution to strictly as per EPF Act. His current annual expenses were Rs 1.20 lac.

He had a very minimum amount of savings and investments which were as follows (Table 1):

Table 1: Investments and savings

Type of investments	Amount (In INR)	Allocation towards
Cash in hand	75,000/-	Emergency Fund
Provident Fund A/c (As on 1.04.2009)	1,25,000/-	Retirement Account
Bank Fixed Deposit	1,10,000/-	Emergency Fund
Mutual Fund Equity	4,00,000/-	Children Marriage
Kisan Vikas Patra	1,50,000/-	Children Education

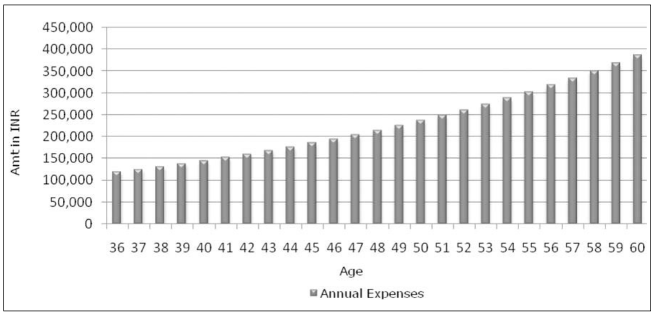
After detailed interactions with him we made following assumptions (Table 2):

Table 2: Assumptions

Inflation	5%
Risk free rate of return	8%
Expected return - Post retirement	8%
Expected return - Pre retirement	10%

Agarwal's expected annual expenditure at the time of retirement was worked out to be Rs 3,87,012 based on his current annual expenses after adjusting for inflation at 5% considering that he will maintain the same lifestyle post retirement (Chart 1).

Chart – 1: Increase in Annual Expenditure of Mr. Rajkumar till retirement.

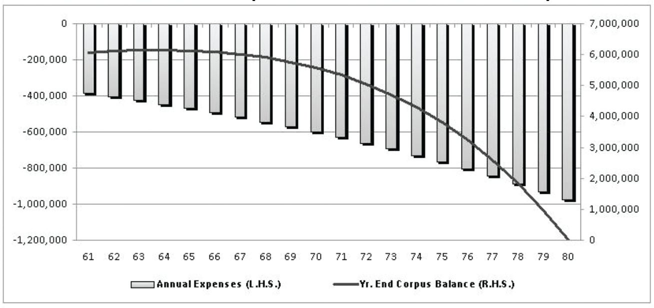


Based on above annual expense requirement of Mr. Agarwal, our next step was to find the amount of retirement corpus which will be required by him as per expense replacement method. After taking into account the annual expense requirement, life expectancy and inflation adjusted rate of return we calculated the retirement corpus which worked out as Rs.60,01,273. The detailed calculation is shown in the following table (Table 3):

Table 3: Calculation of retirement corpus

Annual expense in retirement year (as calculated above)	Rs.3,87,012
Post retirement return	8%
Inflation	5%
Real Rate = (1.08/1.05) – 1	2.8571%
Retirement Age	60 yrs
Life Expectancy	80 yrs
Post Retirement period/ Distribution Phase	20 yrs
Retirement Corpus	**Rs.60,01,276**

Chart 2: Retirement corpus vs. Post retirement annual expenses



The graph (Chart 2) highlights the consumption of retirement corpus with increasing age and increasing annual expenses and at the end of Mr. Agarwal's assumed life expectancy the corpus becomes zero.

After the calculation of the retirement corpus which will be required by Mr. Agarwal, our next step was to ascertain the retirement benefits which he was entitled from his employer.

Therefore at the time of retirement, he would be eligible to receive the following benefits:

- Provident Fund
- Gratuity
- Pension

In order to ascertain the amount which he will be entitled to receive we calculated the expected provident fund that will be available at the time of retirement. The expected future value of the provident fund at the time of retirement turned out to be Rs. 17,94,490/- (Table 4). Similarly the expected amount of gratuity and pension were expected to be Rs. 3,50,000/- (Table 5) and Rs. 3,06,400/- (Table 6) respectively.

Table 4: Calculation of expected amount of provident fund

Monthly salary of 2009-10	Rs 12,500
Maximum salary for EPF contribution	Rs 6,500
Employee contribution to provident fund	12% of basic salary
Employer contribution to provident fund	3.67% of basic salary
Monthly contribution towards EPF	Rs 1,019 (15.67% of Rs 6,500)
Annual Interest rate in EPF	8.5%
Monthly effective interest rate	0.68215%
Expected future value of provident fund at the time of retirement	**Rs 17,94,490**

Table 5:

Calculation of expected gratuity amount at the time of retirement

Projected monthly salary on retirement (growing @ 10%)	Rs 1,11,929
No. of years of service	31
Gratuity receivable	Rs 20,01,807
Gratuity receivable as per the act	**Rs 3,50,000**

Table 6: Calculation of monthly pension amount post retirement

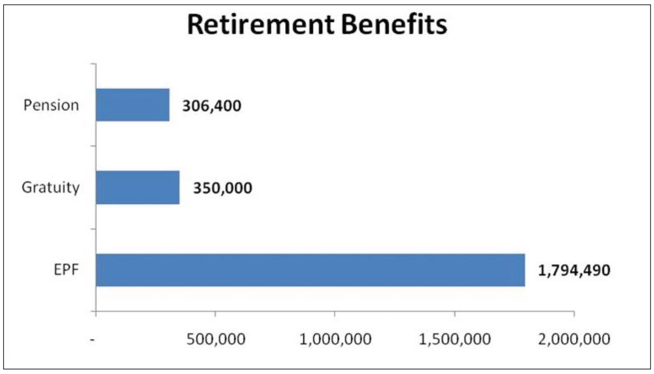
No. of years of service	31
Pensionable Salary	6,500
Pensionable Service = 31+2 (2 Yrs extra for completion of 20 yrs of service)	33
Pension Receivable (6500*33 / 70)	3064
Pension equivalent to 100% commutation	**3,06,400**

Based on above calculations, Mr. Agarwal's total employer's sponsored retirement benefit were expected to be as follows (Table 7):

Table 7: Retirement Benefits expected from employer's sponsored plans

Particulars	Amount (in INR)
Provident fund	17,94,490/-
Gratuity	3,50,000/-
Pension (assumed to be fully commuted)	3,06,400/-
Total	Rs. 24,50,890/-

Chart 3: Retirement Benefits expected from employer's sponsored plans



Gap in retirement corpus versus employer sponsored plans

After the calculation of the amount receivable from employer sponsored schemes we observed that there was a huge shortfall (Table 8) in the amount which will be required by Mr. Agarwal post retirement and the amount available for supporting his post-retirement expenses.

Table 8: Shortfall

Particulars	Amount (in INR)
Corpus required for supporting post-retirement expenses	60,01,276/-
Accumulated amount from employer sponsored schemes	24,50,890/-
Shortfall	**35,50,386/-**

Recommendation

Based on the client requirement of planning for his retirement and above findings about his employer sponsored retirement benefits, we recommended him to start a systematic investment plan (SIP) in a diversified equity mutual fund for a monthly amount of Rs 3,173 to meet the gap as projected in retirement corpus.

Short fall	Rs. 35,50,386
Period of service left	24
Expected rate of return	10% p.a.
Monthly contribution required (Assuming beginning of the month)	**Rs. 3,173**

It is imperative that the above plan is required to be monitored on yearly basis, as any changes in employment, salary, interest rate, inflation and investment experience would directly affect the plan. Suitable changes can therefore be recommended in time.

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