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LOOKING BEYOND EPF

You need to diversify your portfolio for a financially secure life after retirement

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RIPUDAMAN Singh, 41, a professional working in the e-commerce industry, plans to retire at the age of 60. Till about four years back, he was relying solely on his employees' provident fund (EPF) for retirement savings. Singh got a rude shock when his financial planner told him that he won't be able to afford his current lifestyle during the sunset years with only the EPF money.

There are many people like Ripudaman who rely only on their provident fund for retirement expenses. EPF is a tax-efficient, long-term investment product but contributions to it are limited — 12 per cent of the basic salary and matching employer contribution.

Part of the employer's contribution (which is 8.3 per cent, generally subject to a maximum of ₹1,250) goes towards employees' pension scheme. Frequent withdrawal is also common, which brings down the corpus. EPF is predominantly a debt instrument.

It was allowed to invest in equity only recently, and the exposure is limited to 15 per cent. It is difficult for a debt-heavy instrument to generate inflation-beating returns.

ASSET ALLOCATION

Once you realise that EPF alone will not be enough to meet your retirement needs, you need to start additional investments, whose returns will depend on the asset allocation (see: Final Figure). So, before exploring the instruments, decide on how much you need to invest in equity, debt or any other asset. "Asset allocation can be decided after considering expenses and goals after retirement, risk profile, liquidity, income needs, time to goal, taxation, etc," says Suresh Sadagopan, Founder, Ladder7 Financial Advisories. If you are not able to ascertain your asset allocation, take the help of an adviser.

Here are a few options you can use for retirement planning. Voluntary Provident Fund: You can enhance your EPF contributions to over and above the mandatory 12 per cent. For this you can open a voluntary provident fund account. The employer is not obliged to contribute to this account.

While this investment avenue is relatively stable, do bear in mind that returns are low, so you may need heavy additional investments.

Public Provident Fund (PPF): This is a favoured debt instrument as it offers guaranteed returns and is a route that non-salaried individuals, who don't contribute to EPF, can take.

There is a lock-in of 15 years but you can continue the account after maturity by extending it in a block of five years indefinitely. This will help you accumulate more. For example, if you invest `1.5 lakh (maximum allowed in a year) per year for 15 years, you will be able to accumulate ₹44 lakh assuming an interest rate of 8 per cent.

But if you increase the tenure to 10 more years and contribute regularly, you can accumulate ₹1.18 crore. PPF is known to give one of the highest post-tax returns among fixed income options. However, PPF too may not be sufficient to fulfil your retirement corpus needs.

5 YEARS
period of indefinite extensions available on PPF accounts after maturity

EQUITY BOOSTER

The average inflation over the past 15 years has been around 7.06 per cent, while average EPF returns over this period have been 8.75 per cent. At the same time, the S&P BSE Sensex delivered an annualised return of around 13 per cent till the end of 2018. Say, you are 35 years old with current spending of `30,000 per month. Assuming annual inflation of 6 per cent, this amount will become ₹1.29 lakh per month when you retire at 60. To meet expenses for 25 years after you retire, you will need a corpus of around ₹3 crore. If we assume EPF accumulation of ₹5 lakh from 10 years of service starting at the age of 25 and your current basic salary is ₹25,000, you will be able to accumulate ₹1.41 crore through EPF, which will clearly be insufficient.

If you invest in a conservative option like EPF to bridge the gap, the amount will have to be a high as the rate of return is lower. In the example above, to meet the shortfall of ₹1.61 crore, you will have to invest ₹17,753 monthly in an option that gives 8 per cent returns, and ₹9,570 in an instrument that gives 12 per cent.

The point here is that to build a sufficiently large retirement corpus, investments need to earn high returns, and for that investing in equity is a must. Here are a few ways to do that.

National Pension System (NPS): This is a defined contribution long-term retirement scheme which was opened up for all citizens in 2009.

You can take exposure to four asset classes – equity, government bonds, corporate bonds and alternative investments. You can invest up to 75 per cent in equity and 5 per cent in alternative assets. You can choose from two investment strategies: active and auto. Under active choice, the investor takes the call on how much allocation goes to different asset classes subject to the maximum limits. Under the auto choice, there are three Life Cycle Funds with predefined equity allocations as per the subscriber's age. Under the aggressive option, equity allocation can go up to 75 per cent; this is 50 per cent under the moderate option and 25 per cent under the conservative option.

NPS is a low-cost option. With both active and auto options, NPS holds appeal for both those who want to actively manage their asset allocation as well as for those who want to leave it to the fund manager. NPS recently became more tax efficient as it has been given exempt, exempt and exempt status on a par with EPF. There is an additional tax break (over and above what's allowed under section 80C) of ₹50,000 (under section 80CCD(1B).

Once you retire, 40 per cent of the retirement corpus has to be compulsorily invested in an annuity product. "Annuity options available in India are not yet in line with privileges enjoyed by those in developed nations, especially in case of private sector employees and the self-employed," says B. Gopkumar, ED and CEO, Reliance Securities.

The choices are limited as one can choose only from the empanelled annuity providers. "In India, returns on annuity products are not tax-free, making them look less attractive as compared to other retirement solutions such as EPF or PPF," says Aalok Bhan, Director and Chief Marketing Officer, Max Life Insurance.

"To get a reasonably good income on retirement, proper allocation between annuity and other higher return yielding assets has to be done," says Lovaii Navlakhi, MD and CEO, International Money Matters. NPS is a long-term product; withdrawals before maturity are possible only under certain circumstances. It does not give 100 per cent equity exposure, so if you want higher exposure, you have to supplement it with other instruments.

Mutual funds: Investing in equities through mutual funds is a good option. "As retirement is a long-term goal, equities fit perfectly into the groove," says Rajesh Cheruvu, CIO, WGC Wealth. Equity mutual funds offer the benefit of diversification and help you invest systematically. There are special mutual fund options designed for retirement saving. Unlike normal mutual funds, these funds have a lock-in of three-five years and higher exit loads, to restrict withdrawals. These are generally hybrid funds with different allocation to equity and debt under different plans. They also offer the flexibility to switch between plans after the lock-in period is over. However, investing for the short term in equity mutual funds is risky as markets are volatile. Therefore, these are suitable only for investors who can stomach that kind of volatility and have the discipline of staying invested for the long term.

POWER OF COMPOUNDING

As retirement is a long-term goal, most people tend to delay it. "Retirement planning in India has not picked up at the speed it should, with only one in four Indians actually thinking about retirement, and this is happening later in their life's journey.

People lose out on time," says Dipika Jaikishan, Vice President, MyWay Wealth. Higher life expectancy rates mean you might live longer, for which a larger retirement corpus is needed. To achieve that, use the power of compounding – start early; save regularly. If you invest ₹5,000 per month for 30 years at the rate of 10 per cent, you will be able to build a corpus of ₹1.14 crore. If you delay by 10 years but increase the investment amount to ₹10,000 per month, you will still be able to accumulate only ₹77 lakh. So, start early, even if the amount is small.