Malaysian Financial Planning Council

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Retirement Planning

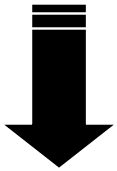
- Human life cycle implies that there will be a period we call retirement during which there is no active income and we have to rely on passive income derived from funds accumulated or through a pension scheme.
- The Malaysian government has a compulsory savings scheme through the Employee Provident Fund which has been the pillar of retirement planning and assets.
- However, the self-employed and business sectors do not have a similar savings scheme. There is a need to address the retirement needs of this sector by the government and the financial intermediaries.
- Most investment representatives focus on this area as it has been established that even the EPF accumulations are not enough to weather the ravages of inflation and poor investment returns. Investments over and above the EPF contributions savings are required to maintain one's lifestyle.

THE FINANCIAL PLANNING ENVIRONMENT, PHENOMENON AND PROCESS

THE FINANCIAL PLANNING ENVIRONMENT, PHENOMENON AND PROCESS

MFPC's DEFINITIONS OF FINANCIAL PLANNING

FINANCIAL PLANNING



A process or methodology of assisting clients in determining their financial goals, objectives and priorities and the resources to meet them in an optimal and practical manner.

THE FINANCIAL PLANNING ENVIRONMENT, PHENOMENON AND PROCESS

OBSTACLES TO ACHIEVING FINANCIAL OBJECTIVES	
Personal obstacles	Deep seated feelings and emotions that includes fear, at the core of people's inability to solve problems when facing complex needs
Lack of confront	Many are unwilling to confront or face the reality of the situation they are in.
Procrastination	Putting off something to later, or for a more appropriate time is a common human characteristic.
Ineffective communication	Effective communication contribute to a better understanding of a client's financial situation.

THE FINANCIAL PLANNING ENVIRONMENT, PHENOMENON AND PROCESS

OBSTACLES TO ACHIEVING FINANCIAL OBJECTIVES

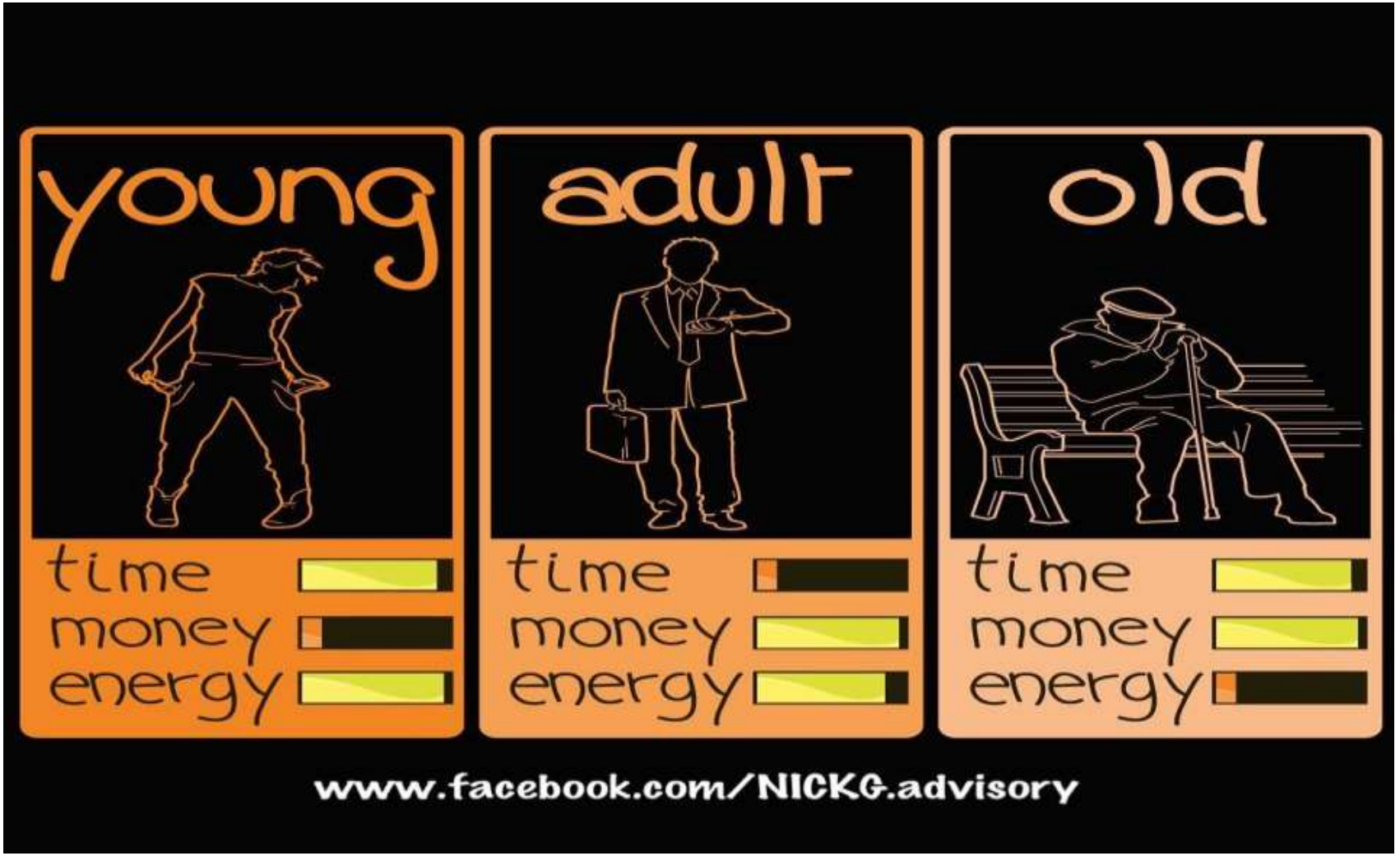
Confusion in the financial services environment	There is a communication overload with financial institutions using the media effectively to promote their products and services.
Inflation and taxes	Inflation has reduced the real returns on most investments, while take a big bite at the available resources
Risks to Income and Assets	Risks can be managed

THE FINANCIAL PLANNING ENVIRONMENT, PHENOMENON AND PROCESS

OTHER ISSUES IN FINANCIAL PLANNING

- Traditional Approach Vs. Comprehensive Approach
- Product Versus Process
- Competent financial planner

LIFE CYCLE


young
time
money
energy
adult
time
money
energy
old
time
money
energy
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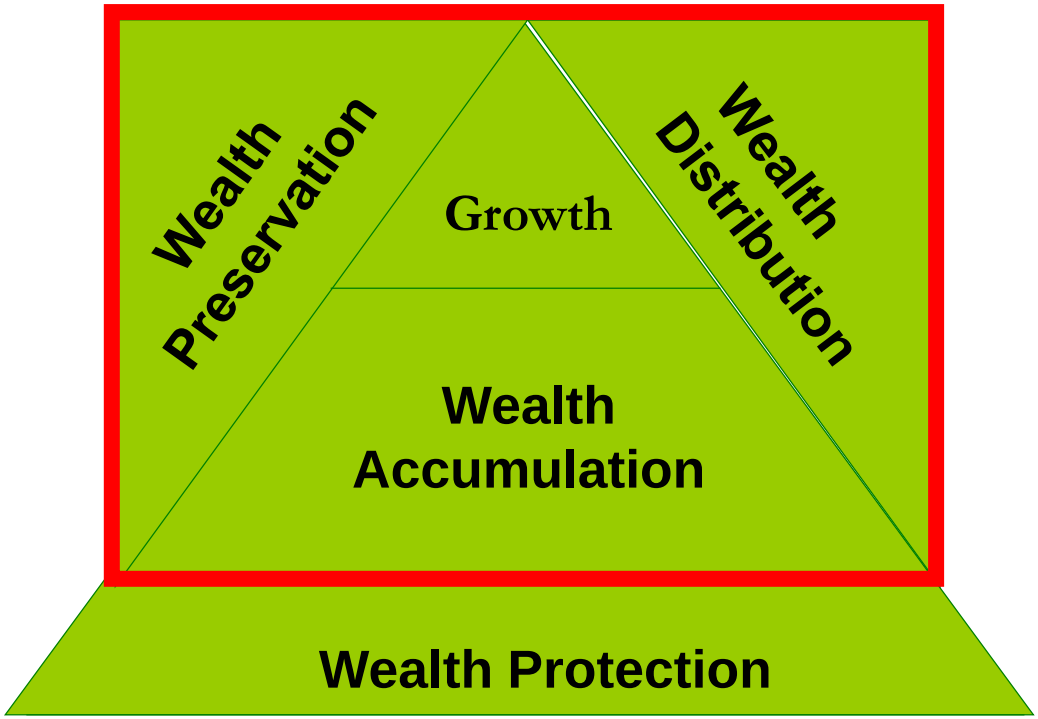
Financial Planning Priorities



Understand Your Finance

- Financial Health Check
- Debt Management
- Risks Profiling

Wealth Preservation & Distribution

- Estate Planning & Wealth Transfer
- Business Succession Planning

Wealth Accumulation & Management

(Serious Money)

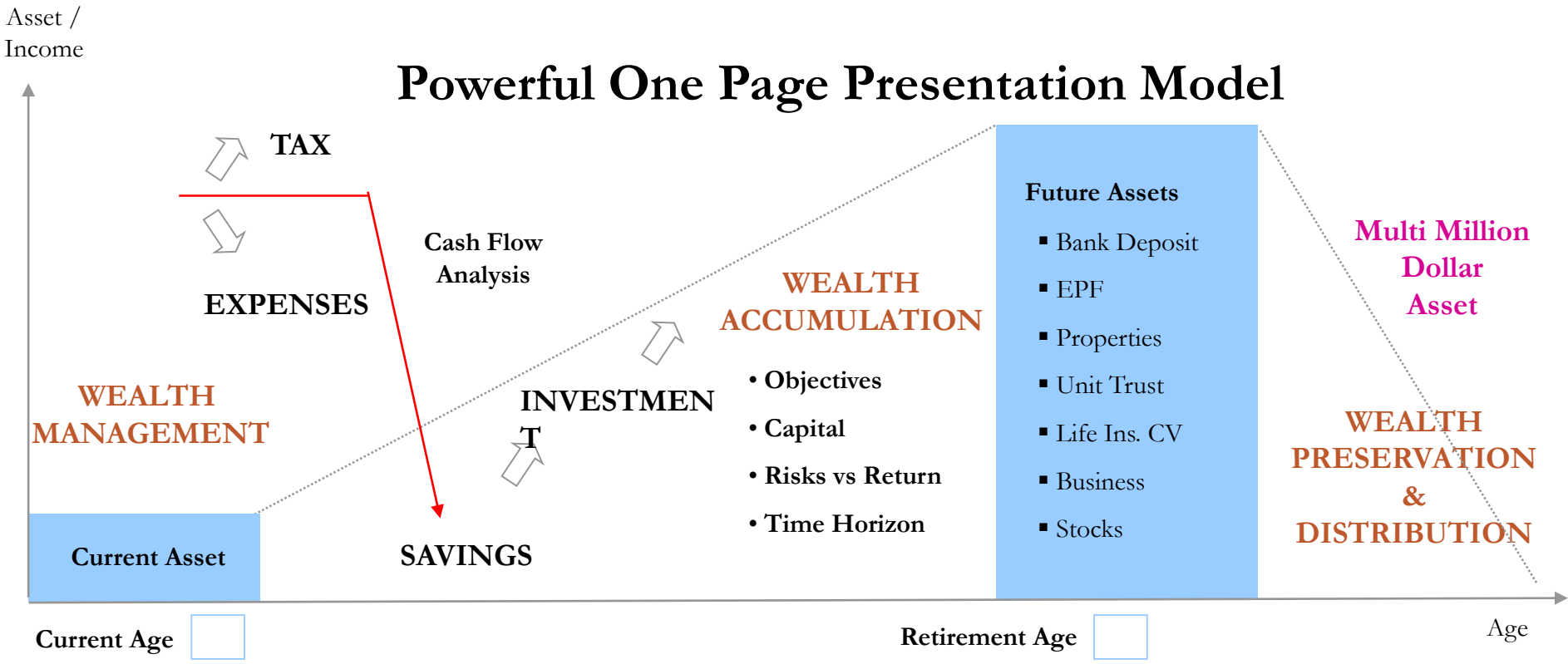
- Family set-up
- Down payment for house
- Retirement fund
- Education fund

Wealth Protection

- 6 month emergency funds
- Income Replacement
- Medical Expenses
- Liability Cancellation


STEP 1
Establish and define Client-Representative Relationship
STEP 2
Data Gathering Including goals
STEP 3
Analyse and Evaluate financial status
STEP 4
Develop and Present Recommendations
STEP 5
Implement Recommendations
STEP 6
Review with Client periodically
ADVISORY PROCESS

Powerful One Page Presentation Model



WEALTH PROTECTION

Risk On Life

Economic Risks

- Economic Crisis
- Inflation

Living Risks

- Diagnosed Illnesses
- Disability
- Death

GOALS
PLANS
DREAMS

FOUNDATION ?

YOU / KEY INCOME EARNER

STANDARD OF LIVING

Goals & Objectives

- Enjoy a comfortable retirement
- Provide tertiary education for my children
- Take care of my family in case of my death, disable or if I strike with major illness
- Protect, preserve and provide my assets for the benefits of my family and loves ones
- Others

THE FINANCIAL PLANNING ENVIRONMENT, PHENOMENON AND PROCESS

Building the Client-Practitioner relationship at all times throughout the process

STEP 1

Setting goals, objectives & priorities

KEY PURPOSE

Establish where the client wants to go and arrange them in order of importance

STEP 2

Gathering relevant data & information

KEY PURPOSE

Procure crucial information for determining the client's situation

THE FINANCIAL PLANNING ENVIRONMENT, PHENOMENON AND PROCESS

TYPE OF INFORMATION
QUANTITATIVE DATA
❖ FAMILY PROFILE
❖ INFORMATION ABOUT CURRENT FINANCIAL ADVISERS
❖ ASSETS AND LIABILITIES
❖ CASH INFLOWS AND OUTFLOWS
❖ INSURANCE COVERAGE POLICY INFORMATION
❖ EMPLOYEE BENEFITS AND CORPORATE PENSION PLANS
❖ TAX RETURNS AND COMPUTATION FOR A FEW YEARS
❖ DETAILS OF CURRENT INVESTMENTS
❖ RETIREMENT SAVINGS
❖ BUSINESS OWNERSHIP DATA
❖ COPIES OF WILLS AND TRUSTS

THE FINANCIAL PLANNING ENVIRONMENT, PHENOMENON AND PROCESS

QUALITATIVE DATA
❖GOALS AND OBJECTIVES
❖RISK TOLERANCE LEVEL
❖ATTITUDE TO MONEY AND ITS VALUE
❖FINANCIAL DECISION MAKING STYLE – AD HOC VS. PLANNED, EASILY PERSUADED, IMPULSIVENESS
❖INTERESTS AND HOBBIES- DEGREE OF INVOLVEMENT
❖HEALTH AWARENESS AND STATUS OF SELF AND FAMILY
❖EMPLOYMENT PROSPECTS AND EXPECTATIONS
❖ANTICIPATED CHANGES IN LIFESTYLE
❖ATTITUDE TO LEARNING AND ADVICE
❖FAMILY RELATIONSHIPS, DEPENDENT CARE AND RESPONSIBILITY
❖ PLANNING ASSUMPTIONS, VIEWS ON ECONOMIC LANDSCAPE, THE GLOBAL ENVIRONMENT

STEP 3

Analyzing information & assessing financial status

KEY PURPOSE

Identifying the clients needs, resources constraints and options

STEP 4

Developing & presenting a financial plan for implementation

KEY PURPOSE

Detailing the problems and solutions in a strategized, written format for the client's considerations and actions

KEY PURPOSE

STEP 5

Executing the financial plan

Getting permission and having the plan implemented effectively and efficiently

STEP 6

Monitoring execution & reviewing of the financial plan

KEY PURPOSE

Checking and adjusting the execution to ensure goals and objectives listed are met

Retirement Planning

Definition of Retirement Planning

" A process of managing an individual's **financial resources**, **expenses** and **liabilities**, both **present and future**, with the purpose of providing sufficient future periodic **passive income** that starts at a predetermined retirement date, for the **individual** and his **dependents**."

Definition of Retirement Planning

Active income:

Employment

Self-employed

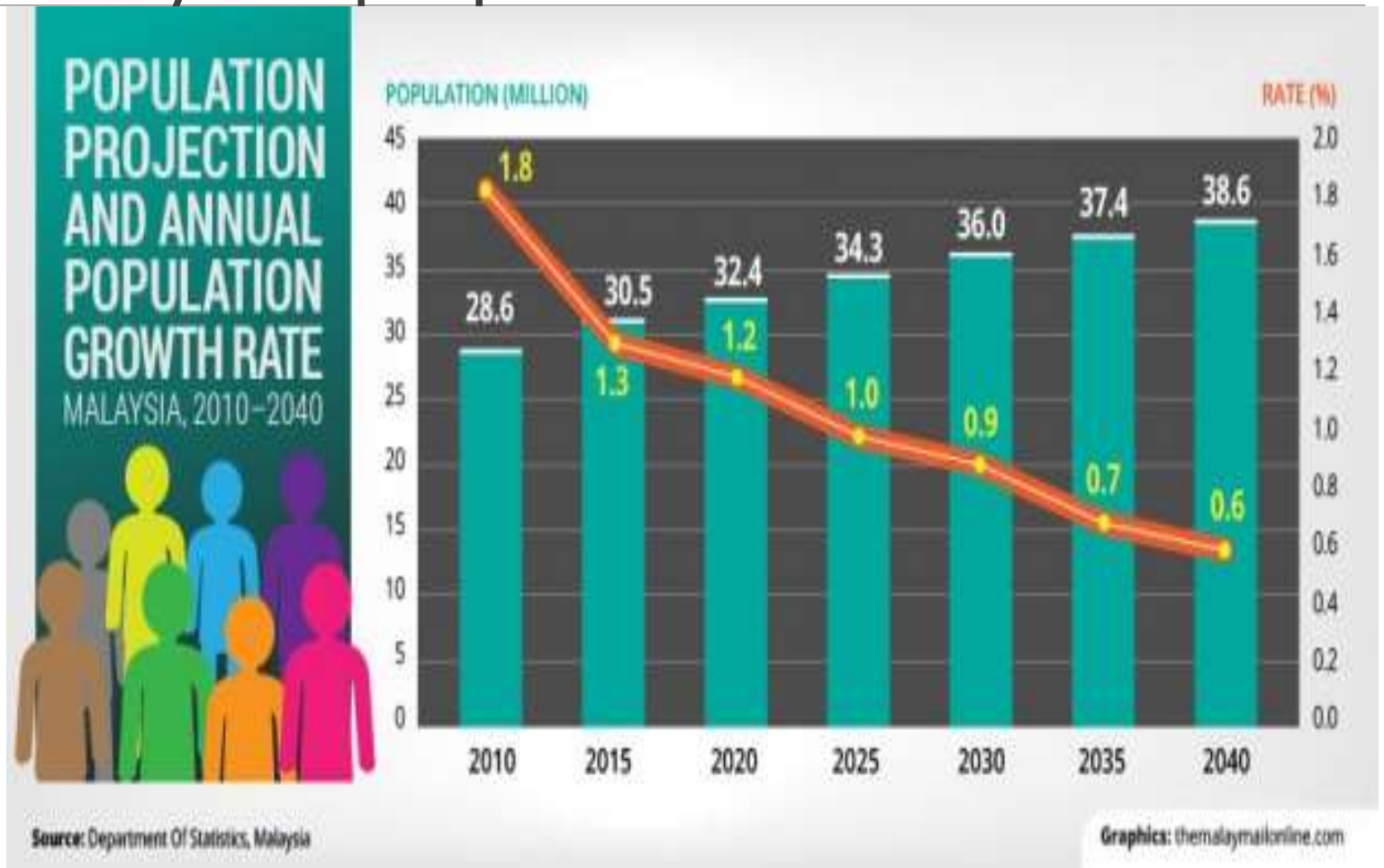
Passive income: e.g. interest income, dividend income, royalty, franchise fees and pension.

Economic death: work generated income ceases.

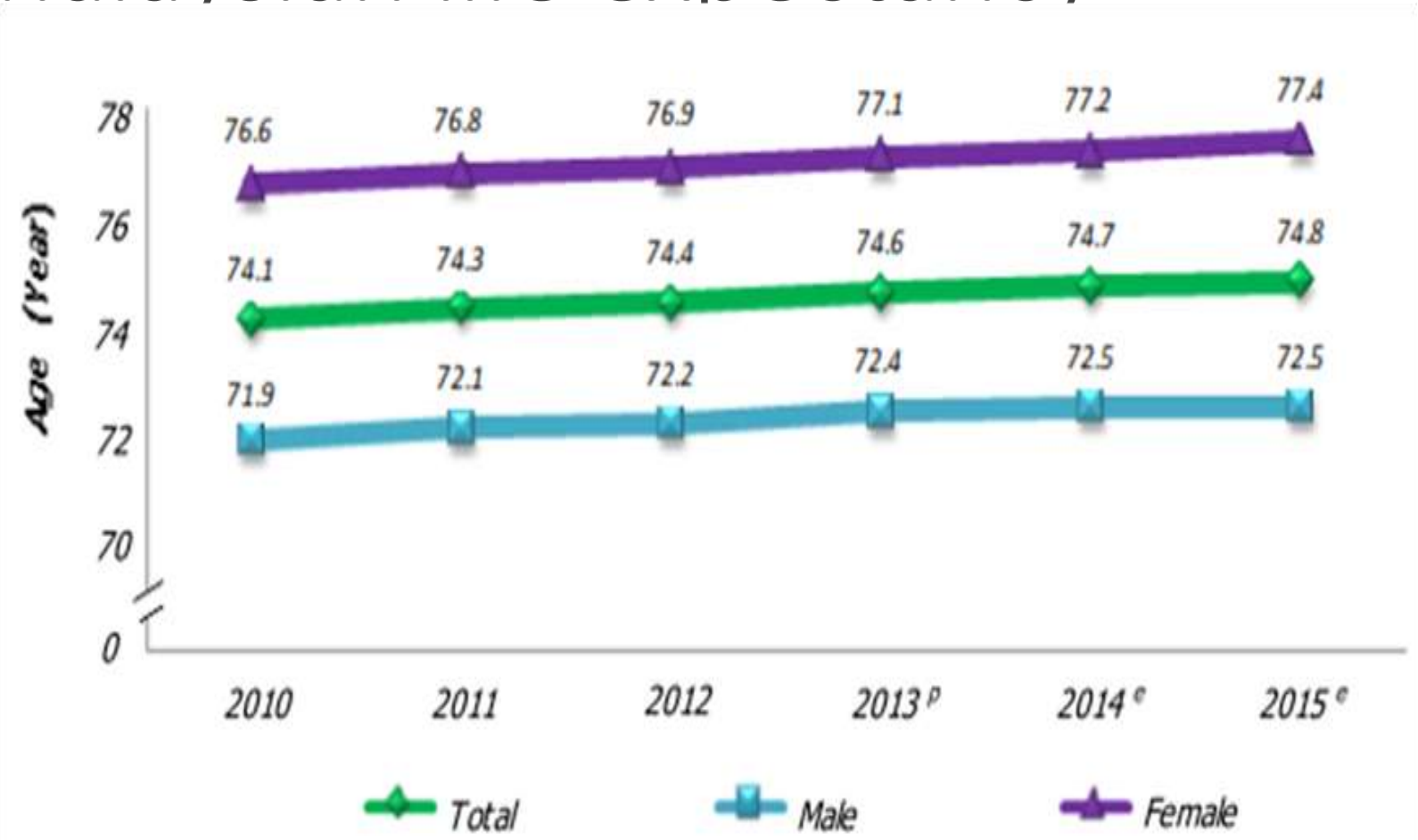
Barricades to Retirement Planning

1. Penchant for High Living
2. Heavy Fixed Commitments
3. Spending Future Dollars
4. Unforeseen Expenses
5. Divorce Maintenance
6. Self-Employed
7. Competing Needs and Temptations
8. Taxation

Malaysia population



Malaysian life expectancy



The life expectancy increase about 1 year within 5 years

Present Picture of Resources for Retirement

Resources available for retirement: (Page 9-14)

- Unit trusts,
- EPF,
- Stocks and shares
- Real Estate
- Business investment.

Resources / Liability not reflected in (Statement of Net Worth)SNW:

- Royalty income or franchise fees,
- Pension, and
- Contingent liability (e.g.. Medical cost)

Non-Financial Aspects of Retirement Planning

- Loss of Identity and feeling of Loneliness
- Health Considerations
- Marital Stability
- Notion on Life Expectancy
- Pre- and Post-Retirement Interest

Understanding the retirement planning process

1. Establishing retirement goals and objectives
2. Gathering data relating to retirement planning
3. Analyzing data to determine client's situation and his retirement needs
4. Designing and recommending a retirement plan
5. Implementing the retirement plan, and
6. Monitoring performance and reviewing

Establishing retirement goals and objectives

1. GATHERING OF QUANTITATIVE AND QUALITATIVE INFORMATION AND ASSUMPTION.

Objective/Quantitative Information	Subjective/Qualitative Information
❖ Assets and Liabilities Inventory	❖ Retirement Goals & Objectives
❖ Wills, Trusts, PA Documents	❖ Risk Tolerance Level and Risk Appetite
❖ Life Policies	❖ Perspective of the Future
❖ Income Tax Returns	❖ Religious Beliefs and Values
❖ Bank Deposits Certificates	❖ Family Relationships
❖ EPF/CPF/Employee Benefits	❖ Investment Preferences
❖ Family/Dependent Profile	❖ Attitude towards Finance
❖ Client's Advisors: Lawyer, Accountant, Insurance Agent	❖ Hopes, Fears and Interests Concerning Retirement

Average rate of return on retirement assets:

Asset Type	Average rate of return per annum
EPF	5.25%
Equity	11%
Real estate	8%
Fixed deposit	4%
Loan stock/bonds	5.5%

Other quantitative assumptions:

Annual amount of retirement fund in today's dollar	RM75k per annum
Inflation rate during retirement	4% per annum
Rate of contribution to EPF by employee	11%
Rate of contribution by employer	12%
Present annual salary plus bonus	RM120k
Average rate of salary increase	5%
Number of years in retirement phase	25

1. Establishing retirement goals and objectives

KEY PLANNING ISSUES: RETIREMENT INCOME NEED

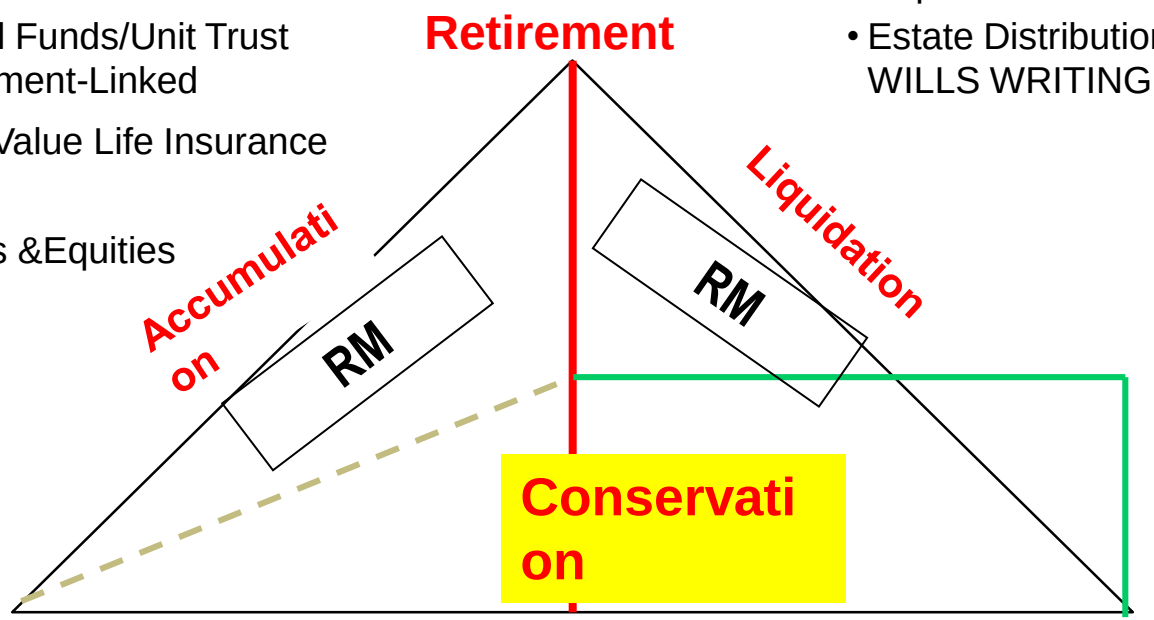
The Variables :

- The Retirement Age
- Expected Mortality Of The Client (Years In Retirement)
- The Income Needed at Retirement – (Replacement Ratio / Expenses Method)
- The Resources For Retirement Income
- The Adequacy Of The Resource at Retirement - Gap
- Closing The Gap – Amount of Savings to Fill Any Deficiency if The Resources are inadequate.

Retirement Planning Strategy
Capital Liquidation & Capital Conservation Method

Asset Emphasis
- Savings
- Real Estate
- Mutual Funds/Unit Trust
- Investment-Linked
- Cash Value Life Insurance
- EPF
- Bonds &Equities
- PRS

Asset Emphasis
- Income Flow
- Capital Preservation
- Estate Distribution
  WILLS WRITING



3. Analyzing data

Determining and Planning for the Client's Non-Financial Need.

- Overcoming the loss of identity syndrome.
- Health Considerations.
- Where a Divorce is Imminent.
- Where the Client Expects to Live Long.
- Pre and Post Retirement Interest.

3. Analyzing data

Determining and Filling The Clients Retirement Needs

1. Determining the 1st year income needed at retirement

2. Determining the required retirement capital.

3. Determining the current and future resources destined for retirement process.

4. Converting the value of current resources to their value at retirement.

5. Determining the funding needed during pre retirement period to meet the lump sum needs at retirement.

3. Analyzing data

1. Determining the 1st year income needed at retirement

The Replacement Ratio Method

Case Study : Mr. Tan, Age 30, Current Annual Income : 100k, expected to retire at age 55, expected retirement income = 80% of last drawn income.

Assumption = rate of income increment = rate of inflation 4%

1) Calculate last drawn income, FV

2) Calculate the 1st year income need at retirement = FV x 80%

Formula

$FV = PV(1 + r)^n$ or

with growth rate (g)

$FV = PV[(1 + r)x(1 + g)]^n$

Another method is **The Expenses Method** which requires the construction of a budget for post retirement.

3. Analyzing data

1. Determining the Required Retirement Capital

The Capital Liquidation Method

Case Study :

First Year Retirement Income = 100k, Rate of Return = 5%, Years in Retirement = 20 yrs, ignore inflation.

1) Calculate Initial Retirement Capital, PV

Formula

PV = A(1+r)[(1-$(1/(1+r)^n]$ ÷ r

The accuracy of the calculation can be further check with use of Excel Worksheet.

3. Analyzing data

2. Determining the Required Retirement Capital

The Capital Liquidation Method

Year	B/B	Annual Usage	Return	B/F
1	1,308,532	100,000	60,427	1,268,959
2	1,268,959	100,000	58,448	1,227,407
3	1,227,407	100,000	56,370	1,183,777
4	1,183,777	100,000	54,189	1,137,966
5	1,137,966	100,000	51,898	1,089,864
6	1,089,864	100,000	49,493	1,039,357
7	1,039,357	100,000	46,968	986,325
8	986,325	100,000	44,316	930,641
9	930,641	100,000	41,532	872,173
10	872,173	100,000	38,609	810,782
11	810,782	100,000	35,539	746,321
12	746,321	100,000	32,316	678,637
13	678,637	100,000	28,932	607,569
14	607,569	100,000	25,378	532,947
15	532,947	100,000	21,647	454,595
16	454,595	100,000	17,730	372,325
17	372,325	100,000	13,616	285,941
18	285,941	100,000	9,297	195,238
19	195,238	100,000	4,762	100,000
20	100,000	100,000	(0)	(0)

3. Analyzing data

3. Determining the Current and Future Resources Earmarked for Retirement Purpose

- Construction of a Balance Sheet and Income Statement would be useful.
- Segregate the income producing assets from non income producing assets.
- Use of Retirement Resources Projected Worksheet.

3. Analyzing data

4. Converting the Value of The Current Resources to their Future Values at Retirement

- Current Available Resources => Calculate the FV with expected rate of return.
- $FV = PV(1 + r)^n$

Assets	Current Value	Rate of Return p.a.	Years To Retirement	Future Value at Retirement
Stocks	150,000	10%	15	626,587
Unit Trust	150,000	8%	15	475,825
Existing EPF	157,000	5%	15	326,598
Total	457,000			1,429,010

3. Analyzing data

4. Converting the Value of The Current Resources to their Future Values at Retirement

- Future Resources of Existing Accumulation Plans for Retirement
- **FV for Annuities**
- FV= PMT x (1 + R) x $[(1+R)^{n}-1] \div R$ (Begin Mode-Due Annuity)
- FV= PMT x $[(1+R)^{n}-1] \div$ R (End Mode-Ordinary Annuity)

Assuming the client invest a Fixed Amount of RM5,000 every year into unit trust and expecting annual return of 8% p.a. for next 15 years.

FV= 5,000 x (1 + 0.08) x $[(1+0.08)^{15}-1] \div 0.08$ =**RM146,621 (Begin Mode)**

FV= 5,000 x $[(1+0.08)^{15}-1] \div 0.08$ =**RM135,760 (End Mode)**

3. Analyzing data

4. Converting the Value of The Current Resources to their Future Values at Retirement

- Future Resources of Existing Accumulation Plans for Retirement
- **FV for Growth Annuities**
- FV= PMT x $[(1+R)^n - (1+G)^n] \div (R-G)$ (End Mode-Ordinary Annuity)

Assuming the client invest and deposited an amount of RM15,000 every year into EPF account with expected salary increment of 4% yearly and expecting annual return of 5% p.a. for next 15 years.

FV= 15,000 x $[(1+0.05)^{15} - (1+0.04)^{15}] \div (0.05-0.04)$ **= RM416,977**

3. Analyzing data

4. Converting the Value of The Current Resources to their Future Values at Retirement

- Future Resources of Existing Accumulation Plans for Retirement
- **FV for Growth Annuities**

Assuming the client invest a client is deposited amount of RM15,000 every year into EPF account with expected salary increment of 4% yearly and expecting annual return of 5% p.a. for next 15 years.

Using Financial Calculator

Step 1 : Find The Adjusted i = (r-g)/(1+g)

Step 2 : Find PV using the i

Step 3 : Find FV using the r

For end mode calculation,

use PV/(1+r) in step 3 calculation rather than PV.

Step 1 : Adjusted i = (5-4)/(1.04) = 0.9615%
Step 2 : N = 15, R = 0.9615%, PMT = -15,000
Compute PV = 208,596.62 (end mode)
adjust PV = 208,596.62/1.04 = 200,573.6
Step 3 : N = 15, PV = 200,573.67, R = 5%
Compute FV = 416,978.25

3. Analyzing data

4. Converting the Value of The Current Resources to their Future Values at Retirement

Assets	Current Value	Annual Contributing	Rate of Return p.a.	Years To Retirement	Future Value at Retirement
Existing Assets					
Stocks	150,000	0	10%	15	626,587
Unit Trust	150,000	0	8%	15	475,825
Existing EPF	157,000	0	5%	15	326,598
Future Assets					
Unit Trust	0	5,000	8%	15	135,760
EPF	0	15,000 with growth rate	5%	15	416,977

3. Analyzing data

5. Finding The Retirement Gap (RG)

RETIREMENT GAP (RG) ANALYSIS	
1. RETIREMENT CAPITAL NEEDS	RM 1,308,510
2. RETIREMENT RESOURCES AVAILABLE	RM 1,992,608
RETIREMENT GAP (DEFICIT / SURPLUS)	RM 684,098 (SURPLUS)

3. Analyzing data

5. Closing The Gap

Assuming the retirement gap is RM107,392 (shortfall)

Regular Funding Approach

PMT = [RG x (r)]÷{(1+r)x[(1+r)^n − 1]}

PMT = [107392 x 0.05]÷{(1+0.05)x[(1+0.05)^{15} − 1]} = RM4,740

Input (Begin Mode)	Value
N	15
R	5%
FV	107,392
Compute PMT	**4,740**

Lump Sum Funding Approach

PV = FV ÷ (1+r)^n

PV = 107392 ÷ (1+0.05)^{15}

= RM 51,657

Combination Funding Approac

Input (Begin Mode)	Value
N	180
R	5%/12
FV	107,392
PV	-10,000
Compute	**321.36**

4. Designing and recommending a retirement plan

Five Areas of Concern :

1. What Does The Client Want At Retirement ?

2. What Are The Client's Financial Retirement Resources ?

3. What Is The Income Needed To Sufficiently Fund The Lifestyle Chosen ?

4. What Is The Additional Lump Sum Amount Needed To Fill The Client's Retirement Needs ?

5. What Must The Client Do From Now On In Order To Meet His Retirement Funding Shortfall ?

Types of Retirement Schemes

The Malaysian retirement schemes is categorized along 2 distinct lines:

1. Public sector vs. private sector;
2. Mandatory vs. voluntary schemes.

Types of Retirement Schemes

Public sector schemes

- Tend to be defined-benefit schemes.
- Kumpulan Wang Persaraan, KWAP and Armed Forces provident Fund, LTAT.
- KWAP provides pensions and other benefits for the retired civil servants and LTAT for the retired armed forces personnel.

Types of Retirement Schemes

- Private sector schemes:
- Tend to be defined-contribution schemes.
- Examples: EPF and employer sponsored schemes.
- The EPF is governed by the EPF Act 1991 and reflects the contributions of both the employers and employees.
- The employer-sponsored retirement schemes come under the purview of S150 of the Income Tax Act 1967 which provides a tax incentive for employers to contribute towards their employees' retirement savings.

Types of Retirement Schemes

Mandatory schemes:

These are schemes that are mandated by law.

In Malaysia, all private sector employees would have to participate in the EPF schemes by contributing a portion of their salary towards their retirement savings.

Types of Retirement Schemes

Voluntary schemes

These are the retirement schemes that are voluntary and not subjected to any legal requirements.

Examples: employer-sponsored scheme and purchase of annuities for retirement.

The Private Retirement Schemes, PRS would fall under this category.

Types of Retirement Schemes:
The World Bank 5 Pillars Pension Framework

Pillar 0	State	Base or social pension
Pillar 1	Mandatory	Public pension, plans that are publicly managed
Pillar 2	Mandatory	Occupational/personal pension plan
Pillar 3	Voluntary	Voluntary personal pension schemes
Pillar 4	Voluntary	Non-financial arrangements/ Informal support

Types of Retirement Schemes:
The World Bank 5 Pillars Pension Framework

Pillar 0	State	Available in Malaysia	Provided by Welfare Dept
Pillar 1	Mandatory	Not Available in Malaysia	
Pillar 2	Mandatory	Available in Malaysia	KWAP, LTAT, EPF
Pillar 3	Voluntary	Available in Malaysia	Employers' sponsored plan, Unit Trust, Annuities, Insurance Products, PRS
Pillar 4	Voluntary	Available in Malaysia	Informal financial support, care for parents, increasing less

Life Expectancy @ 2011

Life expectancy	Hong Kong	Singapore	Malaysia
Population	82.12	83.75	74.04
Male	79.39	81.47	71.28
Female	85.05	86.2	76.99

Age Structure

Age Structure	Hong Kong	Singapore	Malaysia
0-14	11.6%	13.8%	29.6%
15-64	74.8%	77.0%	65.4%
65>	13.5%	9.2%	5.0%

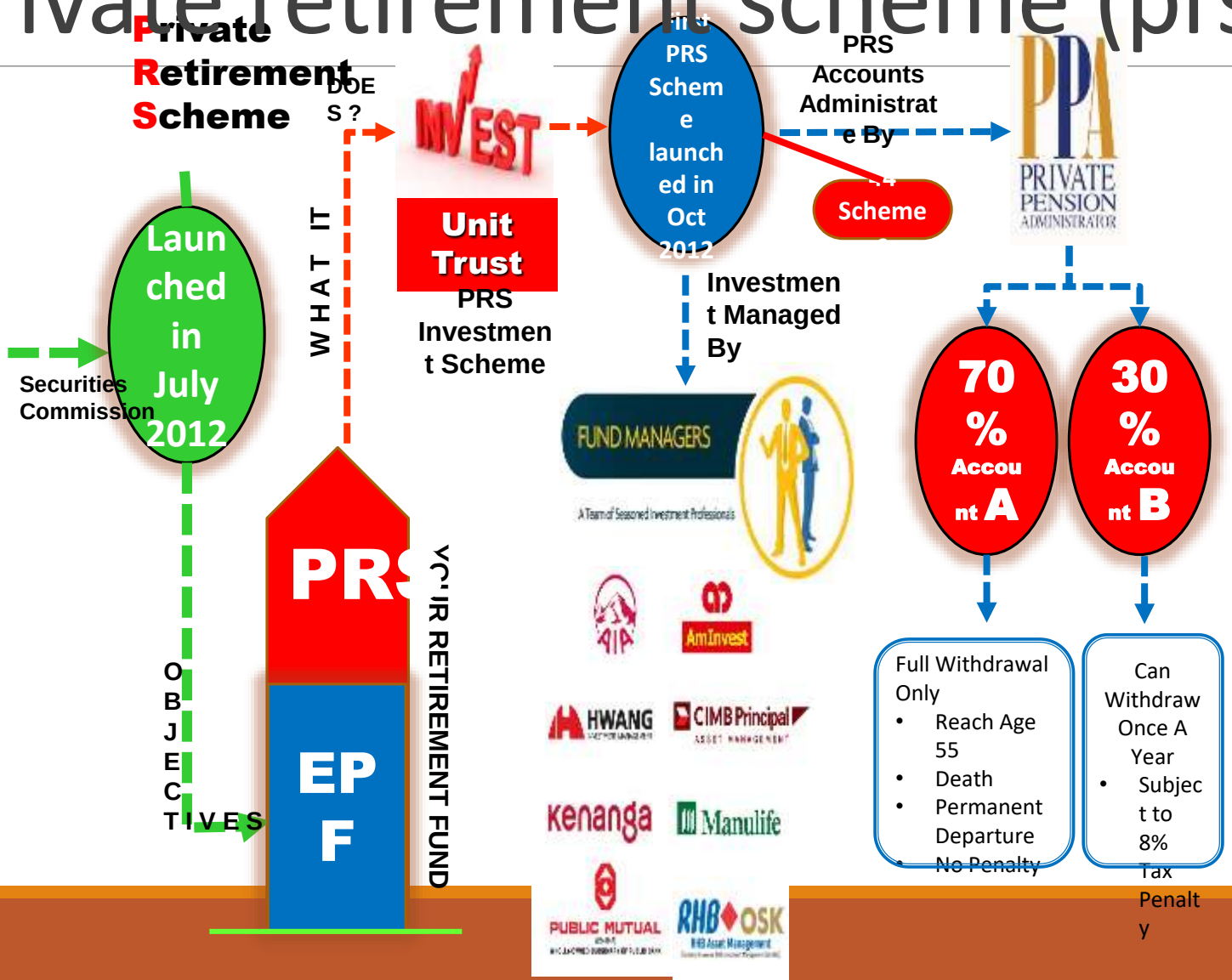
Malaysian Life Expectancy

Life Expectancy	Male	Female
1950s	56	56
2012	71	76
2020 (expected)	75	79

Malaysian Above Age 55

	Population above age 55
1980	8%
2020 (expected)	16%

Private retirement scheme (prs)



REGULATORY FRAMEWORK

Summary of Roles and Responsibilities

Securities Commission (SC) Malaysia

•empowered by law to be the regulator of the PRS industry
•provide a regulatory environment
•development of PRS industry

Private Pension Administrator (PPA)

•provide a life-time central account management, facilitating transactions and promoting efficient administration
•acts as a one-stop resource centre
•educate the public and promoting awareness on PRS
•provide central administration and developing the industry
•protect members' interest