My Financial Planning Journey for Retirement

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One of my life goals is to retire before the age of 55 and be a free man enjoying my life without obligations to anyone at any time! To be a free man, I must be financially independent. This means I would never have to ask financial support from my children or from other relatives during my retired life with my wife. In addition to living expenses, I must be able to pay for my personal and wife’s old age medical costs plus the cost of a world tour which is another one of my life goals. This article is written to share with readers my experience of how I got myself ready for retirement aged 51 in 2011. It is my actual experience of planning to be a free man financially. This article has fictitious numerical figures but factual statements of my planning process and considerations to achieve a few other of my life goals. Readers are free to use this article for research purpose or as a base for your personal planning. I believe that the planning would be the same whether you are employed or self-employed except that the self-employed have another complication which is when the business is to be sold off before he or she retires.

In 2006, when I was in my 5th year serving as the CEO of AmAssurance Berhad under AmBank Group, my two years’ employment contract was renewed by the board of AmAssurance Berhad for the 2nd time. After the renewal, I realized that I would eventually be asked to retire by having my employment contract not being renewed and I might not be ready for retirement. I told myself that when it was the time for me to go, I had to go at my own will and on my own conditions. Then the first question was “when is the right time and condition for me to go?” and I knew that without planning and execution, the right time and right conditions for retirement would never arrive and one day I would be asked to retire when I might not be ready to retire financially. So my planning started in May 2006 when the 2nd renewal of my employment contract got me thinking about it.

We must understand that our financial responsibilities will not end as long as we are still alive. The last expenses for all humans are our funeral expenses which may be paid either by us or our children. I prefer these to be paid by myself through planning. Therefore, financial planning, including planning for funeral expenses, estate planning and the execution of the plan...
are crucial if you really want your lifestyle to be that of a “free man” after retirement from your working life.

I started the financial planning by listing the conditions or liabilities that I would still continue to shoulder after my retirement from working life. Once these liabilities were identified, I had to make sure that I would be able to pay for these liabilities throughout my retirement life before I could tender my resignation and retire as a free man. My post retirement liabilities were identified as follows:

1. Education Cost of my Children (Education Fund)
As a responsible father, I had to pay off the education cost of my children. We must know that the timing of paying off the cost of children’s education and retirement can be at different. It is not necessary that we must retire only after the children complete their education, as is commonly believed by parents. In 2006, I had three school-going children and I made an estimation that the youngest child would graduate with his bachelor's degree in 2015/2016. With the information I obtained from the internet for an American degree, living expenses plus the inflation cost in USA, I estimated the amount I needed per semester was RM70. With 10% inflation cost for tertiary education in the USA, my children’s tertiary education fund was estimated at a discount of 3% Fixed Deposit (FD) rate:
   • Child 1 had one more year to complete his tertiary education:
   • Child 2 was in high school and would be admitted to a university in 2007: $RM140 \times 1.10/1.03 + RM140 \times (1.10/1.03)^2 + RM140 \times (1.10/1.03)^3 + RM140 \times (1.10/1.03)^4 = RM661.78$
   • Child 3 would only be going for tertiary education in 2013: $RM140 \times (1.10/1.03)^5 + RM140 \times (1.10/1.03)^6 + RM140 \times (1.10/1.03)^7 + RM140 \times (1.10/1.03)^8 = RM1,116.47$

Total for the education fund is $RM140 + RM662 + RM1,116 = RM1,918$ or RM2 million.

The estimation must be conservative for the fund to be sufficient at a good confidence level, such as do not consider the earnings of children working part-time jobs while studying.

In my estimation, I ignored the foreign currency risk and hoped the conservative fund estimation would be able to shield me from such risk.

2. Medical Cost (Medical Fund)
The medical cost for my family of five members was impossible to estimate over a horizon of at least 25 years for myself and my wife using the published life expectancy of Malaysians. I reckoned that if the fund was established based on certain assumptions, the fund had to be reviewed regularly for its sufficiency and new money had to be injected if the review showed that it was not sufficient. The injection of new money could pose a big problem and risk to me during my retirement life. Therefore the best option was to purchase a medical
insurance plan for each of us with the plan limit of RM1 million coverage of medical cost. This option provided me a fixed amount per year to pay for the medical cost of my family. Hence it was easier to estimate the medical fund by using the yearly premiums for 25 years plus the expected increase in premium rate due to the medical cost inflation. In my estimation of the fund, I made an assumption that my children would be financially independent by the age of 25 and they would take over the payment of medical insurance premium by then. Again, I was conservative in the estimation, because youngsters today start working as early as 22. I subsequently shared the age assumption with my children so that they could work towards their financial independence at the age of 25. Five medical insurance policies were bought in 2007 for my family and the fund mainly consisted of yearly premiums of my wife’s and my medical insurance policy. The fund was estimated to be RM200,000.

3. Committed Expenses Prior to Retirement
When a person retires, I am sure there are financial commitments made long before retirement. Housing loans and insurance premiums of life insurance policies bought prior to the retirement would be continued into retirement life. Any other loans that have no tangible and appreciable assets to back up, such as personal loan, car loan, and credit card loans, must be paid off before retirement because these loans generally have high interest rate charges, such as 10% or more, and therefore these loans are a drain on your asset and savings. I do not think that you could find a relatively safe investment in the world that can earn a return to pay for the interest rate charged by these kinds of loans. For instance, credit card loans charge 10% or more per annum for the outstanding balance unpaid. There is no safe asset in the world allowing you to earn at least 10% to pay for the interest charged by the credit card company on a yearly basis unless you are betting on a risky investment which sometimes can earn a return of 20% or more but the risk of losing your investment is relatively high too. During retirement life, it is not advisable to invest life savings in high risk-high return investment vehicles. Therefore these loans must be paid off before your retirement and you are strongly advised against acquiring such kinds of loans after retirement.

The following were the options for my housing loans: (i) withdraw savings to settle housing loans upon retirement; (ii) continue paying the housing loans installments into my retirement life; or (iii) combination of the two above. At any point in time, I knew the amount of my outstanding housing loans, the monthly installments to serve the housing loans and the interest rate charged under each loan agreement. With this information, I compared my savings and yearly interest rate earned by my savings. I then decided on option (ii) for the following reasons: (a) Since the savings in my EPF account was
earning at a rate higher (around 6% per year) than the rate charged (between 4% to 5% depending on the prevailing BLR) under the loan agreements by the bank and the total amount of the outstanding housing loans was lower than the savings I had in my EPF account, hence I considered my outstanding loans to have been fully paid off. For example, if you have RM1 million in EPF (or any investment vehicle) earning at the rate of 6% and your outstanding loan is RM800,000 being charged at 5%, you can consider your outstanding loan is being paid off.

However, the regular loan repayment was made from another saving account which earned less interest than the rate charged by the bank. One can argue that I could have used the savings from this other saving account (which was earning less return than the rate charged by the loan agreement) to settle the outstanding loan. I could do that, but I did not because I wanted to keep the cash in this saving account available for an investment opportunity that may earn higher returns than the rate charged by the loan agreements. If it was really necessary for me to pay off the housing loans, I could withdraw money from my EPF account any time to pay off the housing loans. Therefore no fund was needed to be earmarked specifically for the housing loan here since the housing loan had been considered paid off.

As for the life insurance policies, the options available were: (i) surrender my life insurance policies; (ii) continue to pay the regular premium until maturity or death whichever happens first; (iii) cease payment and apply for non-forfeiture options under the insurance policy contract; or (iv) any combination of the above. The option you select depends very much on the situation you are in. For my situation, my kids were still dependent on me, hence I had no choice but option (ii). However I would review my choices again when I eventually retired in four or five years after 2006 because one or two of my kids might be financially independent when I retired. If option (ii) was still chosen when I retired eventually, a Life Insurance Fund had to be earmarked and put aside. For the time being, I still could service the regular premiums from my monthly salary and hopefully my passive incomes after the retirement would be sufficient to pay for the regular premiums.

4. Household Expenses
Living expenses and the maintenance of cars are daily expenses which can be estimated easily. These amounts can either be met by setting up a fund for you to draw down on a monthly basis or be met through passive income which will be discussed below. For me, I decided these expenses were to be met through my passive income which meant no fund was specifically earmarked for this item.
S. Travel the World (Travel Fund)
My wife and I wish to take three holidays overseas and few local holidays in a year. This wish is not cast in stone. Even if an overseas travel fund was established, we could always make changes from time to time depending on the size of the fund and other needs for the money in the fund. We decided on an arbitrary amount such as RM300,000 and earmarked it as Travel Fund. At any time if we had extra cash, the cash could be put into the fund. The fund is also considered as an emergency fund which can be drawn down for emergency purpose at the expense of our world tour.

These were my liabilities. Three required funds were identified:

1) Education Fund: Estimated to be RM2 million
2) Medical Cost: Estimated to be RM200,000
3) Travel Fund: RM300,000
4) Daily cash flows for household expenses identified.

To retire, I had to have assets to back up these liabilities. At the point of my calculation in 2006, my total assets were not sufficient to back these liabilities and the shortfall was substantial, at least RM1 million. Hence I could not retire in 2006. But I felt that as days went by, my assets would be growing and my liabilities would be reducing, and based on my earnings and my expenditure pattern in 2006. I estimated that I would have sufficient assets to back my liabilities in 2009.

With the knowledge of asset-liability matching, I divided my liabilities into three classifications and looked for investment vehicles in the market that I could match to the needs of each class of my liabilities. The purpose of the asset-liability matching is to maximize the return of the earmarked funds and also match the cash flow need of the liabilities. I did research to understand what investment vehicles were available for my funds. There are factors that must be considered in the search for investment vehicles, such as size of the fund, duration of the liability period, risk tolerance, and cash flow pattern of the liability, among others.

(1) Short-Term Liability: Education Fund

The education fund for my children is a short term liability and its purpose would be fully met when my children complete their tertiary education, latest by 2016 as estimated. With the financial discipline my children must have (I cannot allow them to ask for money whenever they like or need), the need for a lump sum of cash occurs only at the beginning of each semester which is two times in a year as at summer time, they would either travel around in USA or return home for the summer vacation. This fund has no tolerance for risk and hence the asset had to be put into FD or preference shares of blue chip counters, or government guaranteed bonds. Because of the size of the education fund, I negotiated with the bank officer for the best rate and put it into FD with the maturity dates matching the
need for cash each semester. Because of the conservative estimates for the education fund (10% inflation rate for the education cost and 3% discount rate as the earning rate of the fund), the fund would be sufficient despite the fact that the foreign exchange rate was ignored in my estimate.

(2) Long-Term Liability: Yearly Cash Need for Medical Fund

The size of the medical fund is relatively small because it is meant to pay for the yearly premium of three medical insurance policies until age 25 of my children and two policies until age 70 (the renewability of the medical policy is up to the attained age of 70) for myself and my wife. Thereafter, the fund would continue to pay for the medical cost directly whenever medical attention is needed for my wife and me. Again the fund has no tolerance for risk and cash must be available when the premium is due, hence again the fund was used to buy FD with the best negotiated rate from the bank. The need for cash to pay the yearly premium was done by scheduling the maturity date of FD at the premium due date.

(3) Floating Term Liability: Monthly Cash Need for Committed Expenses

The liability of these committed expenses (housing loan and life insurance policies) is called floating because it can be long or it can be short depending on the stability of the financial environment (it can be any reason causing the financial environment to be volatile, such as economic or political situation or the situation of family emergency) I would be facing. In a stable environment, the liability would be long term in nature and monthly cash would be needed to pay the monthly instalments of housing loans and annual premium of life insurance policies. If my financial situation was desperate, the liability could be shortened by paying off the housing loans by withdrawing EPF money and/or surrendering life insurance policies. Therefore the fund backing this liability had to be invested into long-term assets that had to meet the following three criteria: (a) Assets must have the ability of producing passive incomes to meet the monthly cash need. (b) Assets must not be volatile in value because risk taking is not ideal for retirees. (c) Assets must have the characteristic of being able to appreciate in value over time. Criteria (c) would rule out FDs which would not appreciate in value over time; Criteria (a) and (b) would rule out investments in share stocks, bonds and unit trusts which have no monthly cash flow and these assets are volatile.

With these three criteria, one can consider plantation estate which would produce monthly incomes, and generally the estate would appreciate in value over time, and the land value would not be volatile. However it is advisable to consult a commodity expert or do some research to understand the stability of the commodity prices and the maturity of its market in Malaysia so that you can decide the type of plantation you
may want to invest in, such as oil palm plantation, rubber plantation, castor oil plantation or other types of fruit plantation. Another investment one can consider is commercial property which would also meet all the three criteria. For commercial property investment, a property expert should be consulted or some research should be done to understand the dos and don'ts of property investment. For instance, there are many commercial properties in the property market that are not producing monthly cash flow, and neither can the property appreciate in value. We must learn to avoid these properties.

After some research into the maturity of the industry for various commodities and the stability of their market prices, I then decided to use my savings after the Education fund, Medical Fund and Travel Fund to buy some acres of palm oil plantation because both the upstream and downstream industries for oil palm seeds are mature. Oil palm prices are also less volatile than that of other commodities, like rubber. I was only interested in buying plantations that had oil palm trees that were at least five years old and capable of producing one tonne of oil palm seeds per month in a high yield season.

Instead of putting the entire fund into the palm oil plantation, I also kept aside some cash for the purpose of investing in commercial properties. The cash enables me to have the holding power in case of a general drop in property prices due to the financial environment as described above. I only searched for commercial properties in matured markets with high human traffic and rental income, because only these market could ensure my meeting the three criteria mentioned above. A review of the existing rental agreement is important because the return (ROI) on property is a factor that buyers would consider before purchase. Hence I regularly searched on the internet, in newspapers and among property agents for undervalued properties in the market around the Klang Valley. If you are lucky, one buy and sale transaction can earn you a million ringgit gross.

(4) Household Expenses Liability

The pattern and the amount of household expenses are predictable. The maintenance cost of cars is also predictable except that mechanical breakdown can be costly and unpredictable. However, I believe that this expense could be met by the passive income produced by the oil palm plantation and rental incomes. I always keep some cash in the saving account of the bank to meet any sudden need for cash.

(5) Long Term Liability with Call Option for Travel Fund

The size of this fund is relatively small and the need for cash is ad hoc, whenever travel is planned and/or emergency for cash arises. I decided to put this amount into FD with monthly
maturity and also into blue chips on KLSE because these investment vehicles are liquid and conservative.

The planning and research was done in 2006, the execution of the plan was done over five to six years by looking at some plantations in Bestari Jaya (formerly known as Batang Berjuntai) and Sungai Tengi in Bukit Tagal. Eventually I tendered my resignation at the end of 2010 even though I was ready to retire in 2009. Finally, my financial planning has been executed and meets all requirements as I planned. I am a full-time farmer and a free man now.