

ISLAMIC FINANCE 1ST

Islamic Finance 1st is a Monthly Islamic Finance e-Notes published by SALIHIN Academy

- *Retirement Planning* -

Editor's Note: *The theme for this month Islamic Finance e-Notes is Retirement Planning. Retirement Planning requires deep thoughts and consideration in order to have a sustainable life fit with the desired lifestyle after retirement. Retirement is about considering how the golden years would be like?; The need to prepare for huge medical fees or other emergencies for aging population; The idea that the old generation might live longer now than the average life expectancy. There is a long list of consideration for retirement planning based on Shariah or otherwise and this planning needs to be done thoroughly, professionally and timely.*



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 its dependents.”

Economic death is often the term used to describe the characteristic of retirement. It denotes the period where work-generated income ceases. The retirement risk exists because no one knows when he will die. Anyone who has outlived his working years will necessitate a replacement income to maintain his chosen lifestyle – if he still lives on well after retirement.

Purpose of Retirement Planning

Why would we need to plan for our retirement? Retirement Planning is mainly for two main reasons: 1) To reap the benefits of longer compounding period of the retirement funds which is an inevitable phenomenon – unless we die prematurely; 2) To ensure that when an individual retires, he is able to live his desired lifestyle without or with minimal financial assistance from third party or become a burden to the other family members or the society at large.

Phases in Retirement Planning

1. ACCUMULATION PHASE

Accumulation phase is where an individual starts accumulate his resources for retirement. Most people will agree that accumulation phase starts with employment. Employment starts when an individual took up a job with income. It can be a part time, full time or temporary job.

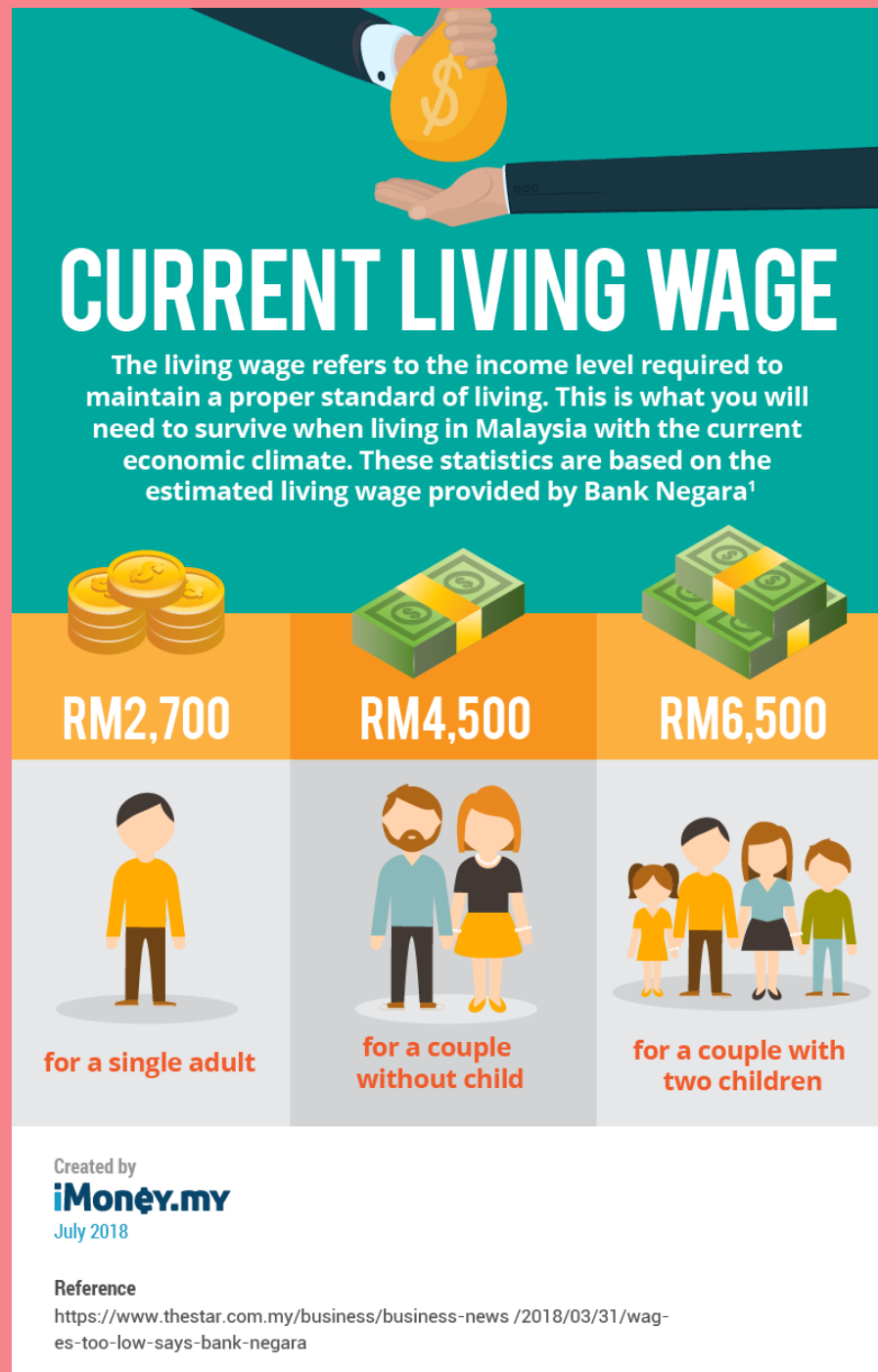
In Malaysia, it is particularly true that accumulation of retirement resources starts with employment because employees and employers are required to make mandatory contribution to EPF; the primary form of retirement sources.

2. RETIREMENT PHASE

Retirement phase is the period where the individual has ceased his active working life. Whatever financial resources accumulated during accumulation phase are being utilized in this phase.

In Malaysia, the retirement age is 60, while in Singapore, the retirement age is 62, and Iceland holds the oldest retirement age, 67. Recently World Bank proposed to raise Malaysia's retirement age to 65 as well as minimum withdrawal age for EPF savings be raised to 65 gradually.

At this age (retirement age), the main focus would be to conserve assets and maintain a sufficient income flow to sustain the retiree's standard of living until he dies.



Source: MFPC (which mainly edited by Dr. Ahcene Lahsasna)

Formula to Calculate Retirement Savings Needs

Most people nowadays are earning salary below the standard living wage as recommended by the Bank Negara Malaysia. Most of single adult receiving less than RM2,700 a month as suggested. How can they have extra cash for their retirement goals? One of the most difficult parts of retirement planning is calculating how much money one should aim to save before retiring. Here are few formulas for consideration:

4% RULE

Divide your desired annual retirement income by 4%. To withdraw RM80,000 per year, for example, you would need a nest egg at retirement of about RM2 million ($RM80,000 \div 0.04$).

80% OF YOUR FINAL PRE-RETIREMENT SALARY

If your final pre-retirement salary is about RM10,000 per month, thus you would need around RM8,000 ($RM10,000 \div 0.8$) per month for 20*** years after you retired at the age of 60.

MULTIPLY CURRENT ANNUAL SPENDING BY 25

For example, if you currently spend RM80,000 per year, you will need an investment portfolio that's 25 times that size—RM2 million at the beginning of your retirement. This sum is large enough for you to withdraw 4% of that RM2 million retirement portfolio in your first year of retirement, and that same 4% adjusted for inflation every subsequent year, while maintaining a reasonable chance that you won't outlive your money.

25% OF YOUR GROSS SALARY EACH YEAR, STARTING IN YOUR 20S

If you follow this formula, it should allow you to accumulate your full annual salary by age 30. Continuing at the same average savings rate should yield the following:

- Age 35—two times annual salary
- Age 40—three times annual salary
- Age 45—four times annual salary
- Age 50—five times annual salary
- Age 55—six times annual salary
- Age 60—seven times annual salary
- Age 65—eight times annual salary

PERCENTAGE OF SALARY BY AGE

Additional savings benchmarks suggested by Fidelity are as follows:

- Age 40—two times annual salary
- Age 50—four times annual salary
- Age 60—six times annual salary
- Age 67—eight times annual salary

Retirement Planning Calculator for Reference

- **Great Eastern:** <https://www.greasternlife.com/my/en/personal-insurance/understand-insurance/financial-tools-to-know-what-you-need/retirement.html>
- **OCBC:** <https://www.ocbc.com.my/personal-banking/lifegoals/Al-Amin/retirement/planner/index.html>
- **Sun Life Malaysia:** sunlifemalaysia.com/life-moments/the-life-stages-chart/retirement/



EPF recommends a minimum amount of RM228,000 by the time you're 55, which gives RM950 in monthly expenditures over 20 years***.

Retirement Planning from Maqasid al-Shariah Perspective

Retirement planning is one of important element under wealth planning from Shariah perspective. It is inline with the four obojectives of Shariah (Maqasid al-Shariah). With retirement planning, we can protect our life and the beloved ones, protect our property as well as intellect as retirement planning secure our future better.

MAQASID-AL-SHARIAH

- Protection of Religion (al-Din)
- Protection of Life (al-Nafs)
- Protection of Intellect/ Mind (al-Aql)
- Protection of Human Being (al-Nasl) / Family (al-'Ird)
- Protection of Property (al-Mal)

RETIREMENT PLANNING

- Ensure sustainability of life after retirement (where monthly source of income has been stopped)
- Ensure livelihood for dependent/ family members after retirement
- Ensure the assets and properties can be retained after retirement
- Ensure harmonization within family members
- Ensure ease and focus on ibadah during retirement
- Provide confidence and peace of mind about the future
- Achieve Maqasid al-Shariah

Wealth Planning for Retirement from Shariah Perspective



WEALTH CREATION

Creation of wealth must be in the permissible ways; income from halal activities, profit from Shariah compliance investment, profit of selling Shariah compliant products etc.

"And should you fear poverty, Allah will enrich you out of His bounty, if He wills. Surely Allah is All-Knowing, All-Wise (At-Taubah 9:29)"



WEALTH GENERATION

In Islam, wealth must not be kept idle, but should be invested based on the Shariah principles; Islamic fixed deposit, Islamic investment account etc. The wealth generation includes expenses budgeting, cash flows calculating, spend less than income, cut out the extras etc. This part is crucial for retirement planning, as what we generate must be able able to meet our retirement goals.



WEALTH PURIFICATION

Wealth needs to be purified to cleanse income earns from unknown illegal sources and share the wealth with others via zakat.

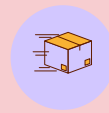
"Take from their wealth 'O Prophet' charity to purify and bless them, and pray for them (At-Tawbah 9:103)".



WEALTH PROTECTION

Takaful scheme is one of the ways to reduce the financial risk such as financial losses due to accident and misfortunes. Subscribe to a few takaful plans that fit your needs and future plans which include your beloved ones; Medical & Family Takaful Plans etc.

"Protect your belief by charity, guard your wealth by paying Allah's share, and ward off the waves of calamity by praying (Hazrat Ali r.a.)".



WEALTH DISTRIBUTION

Wealth distribution deals with faraid, hibah, will, spend on charities and perform zakat obligation.

Prophet SAW said: "Allah said: Spend (on charity) O Son of Adam and I shall spend on you".